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No. 92-___

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1992

LIBERTY MUTUAL INSURANCE COMPANY

and

THE TRAVELERS INDEMNITY COMPANY OF ILLINOIS,

Petitioners,

v.

ELJER MANUFACTURING, INC. f/k/a HOUSEHOLD MANUFACTURING, INC.,

Respondent.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

When a court of appeals reverses a district court summary judgment, may it mandate entry of a contrary judgment based on appellate findings of fact on issues not presented to the district court, or is the court of appeals required by Rules 52 and 56 of the Federal Rules of Civil Procedure to remand the matter so that the district court can determine whether there is a genuine issue of material fact and make findings of fact?

In this case, did the United States Court of Appeals for the Seventh Circuit err when, in a case involving a "difficult and important question of insurance law" having "national significance," it reversed the district court's judgment and mandated entry of a contrary judgment based on the court of appeals' *de novo* findings of fact concerning the supposedly "illusory" coverage provided by the insurance policies and the intent of the drafters of the policy form?

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PETITION FOR WRIT OF CERTIORARI

Petitioners, Liberty Mutual Insurance Company and The Travelers Indemnity Company of Illinois,[1] pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit, entered in this action on August 14, 1992.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Seventh Circuit is reported as *Eljer Mfg., Inc. v. Liberty Mut. Ins. Co. and Travelers Indem. Co. of Ill.*, 972 F.2d 805 (7th Cir. 1992), and is Appendix A to this Petition. The district court's opinions granting summary judgment and disposing of post-judgment motions are reported together as *Eljer Mfg., Inc., The Travelers Indem. Co. of Ill. and Highlands Ins. Co. v. Liberty Mut. Ins. Co.*, 773 F. Supp. 1102 (N.D. Ill. 1991), and are Appendix B and Appendix C to this Petition.

JURISDICTION

The judgment of the United States Court of Appeals for the Seventh Circuit was entered on August 14, 1992.

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[1] Liberty Mutual Insurance Company has no parent corporation, and its sole non-wholly-owned subsidiary is Liberty ALL-STAR Equity Fund. The Travelers Indemnity Company of Illinois is a wholly-owned subsidiary of The Phoenix Insurance Company, which is a wholly-owned subsidiary of The Travelers Indemnity Company, which is a wholly-owned subsidiary of The Travelers Corporation. The Travelers Indemnity Company of Illinois does not have any non-wholly-owned subsidiaries.

On November 5, 1992 the court of appeals denied timely petitions for rehearing and suggestions for rehearing *en banc*. (Appendix D) This Court has jurisdiction pursuant to 28 U.S.C. § 1254.

STATEMENT OF THE CASE

Nature Of The Case

This case raises important federal procedural issues in the context of a dispute over interpretation of the term "physical injury to tangible property" in the 1973 standard form comprehensive general liability ("CGL") insurance policy. The insured contends that, if it sells a potentially defective product for installation in the real property of a buyer but the product either does not cause any tangible change in the buyer's property or does not cause such a change until years later, the installation itself nonetheless is a "physical injury" to that property. The insurers contend that no "physical injury" occurs at the time of installation, but only if and when the product fails, causing a tangible change in the buyer's property.

The district court entered summary judgment in favor of the insurers based on the language of the policy, without having received any evidence from either side of the intent of the parties who contracted for the insurance policy or of the intent of the drafters of the form policy concerning the meaning of the words "physical injury to tangible property." The court of appeals reversed the judgment and mandated the entry of a contrary judgment in favor of the policyholder based on the appellate court's

de novo findings concerning the supposed "illusory" coverage afforded by the policy and the intent of the drafters of the form policy, even though no evidence whatever was presented to the district court on those issues of fact.

Background Facts

The product at issue is a polybutylene plumbing system called "Qest" that was manufactured by a subsidiary of Eljer Manufacturing, Inc. ("Eljer") and sold to plumbing contractors throughout the United States between 1979 and 1986 for installation in houses and apartments. Within a year after the first Qest systems were sold and installed, complaints about leaks in some of the systems were received by Eljer. The first products liability lawsuit was filed against Eljer in 1982. Since then, several hundred similar suits have been filed involving almost 17,000 of the systems. It is estimated that only 5% of all Qest systems ever sold have failed. Nonetheless, Eljer's potential tort liability for Qest claims is in the hundreds of millions of dollars. (A2-3) The reasons for the failures are disputed. They may involve such things as negligent assembly by plumbers in the field or incompatibility with chemicals in the water found in certain locations. (A33)

Eljer brought a declaratory judgment action in the United States District Court for the Northern District of Illinois to determine whether there was coverage for these claims under CGL primary insurance policies issued by Liberty Mutual Insurance Company ("Liberty"). The basis of Federal jurisdiction was diversity of citizenship, 28 U.S.C. § 1332. The Travelers Indemnity

Company of Illinois ("Travelers"), which issued excess insurance policies to Eljer during part of the affected period, intervened.

The Liberty policies covered liability for ***"property damage"*** accidentally caused by Eljer, defined (per the 1973 standard form CGL policy) as ***"physical injury to or destruction of tangible property which occurs during the policy period . . . . "***(A4) The coverage issue here is whether "physical injury to tangible property" occurs when a Qest system is installed in a house or apartment, or not until the system actually leaks, resulting in water damage to the residence. Eljer's position is that such "physical injury" occurs when a defective Qest system is installed, regardless of whether or not the system subsequently leaks. Liberty and Travelers contend that "physical injury" does not occur unless and until there is a leak resulting in water damage to the residence. If there is no such "physical injury" during the policy period, then that policy is not "triggered" – *i.e.*, it does not provide coverage for the asserted claim.

The District Court Judgment

This "trigger" issue was presented to the district court on cross-motions for summary judgment. The district court agreed with the insurers and entered summary judgment in their favor, holding – under Illinois and New York law which governs the construction of the policies – that "physical injury to tangible property" does not occur at the time of installation, but when there is a leak. (A62-63)

The district court's opinion is founded entirely on the language of the policies and on the applicable decisions of the Illinois and New York state courts. Neither side contended that there were material facts in dispute. Indeed, the parties presented to the court a stipulated statement of the relevant facts. (Appendix II In Support of Eljer's Opening Brief On Appeal, pp. 55-121) Eljer, for its part, argued that "the undisputed facts, the decided authorities and the plain meaning of the insurance policies" warranted summary judgment in its favor. (Memo. In Support of Eljer's Motion for Summary Judgment, p. 1) The parties' stipulated fact statement did not contain any evidence of Eljer's or Liberty's intent in entering into the insurance contract or of the intent of the drafters of the 1973 form CGL policy. Also, the stipulated facts offered no evidence of whether the policy construction advocated by Liberty and Travelers would cause the policies to provide "illusory" coverage or even whether it would cause the policies to provide greater or lesser amounts of coverage in the aggregate than the policy construction advocated by Eljer.

In its summary judgment opinion, the district court held that, under Illinois and New York law, installation of a Qest system does not constitute "property damage" because installation (without more) does not result in "physical injury to tangible property" as required by the policy definition. (A45-47) As the district court noted, the 1973 form CGL policy – at issue here – differs from the prior 1966 form policy in that the latter defines property damage in terms of "injury to tangible property" without any requirement that the injury be "physical." (A50-52)

The district court's conclusion about Illinois law was based on the Illinois Supreme Court's decision in *United States Fidelity & Guar. Co. v. Wilkin Insulation Co.*, 144 Ill. 2d 64, 578 N.E.2d 926 (1991), a case seeking coverage under both the 1966 and 1973 form CGL policies for property damage allegedly caused by asbestos-containing insulation in buildings. In *Wilkin*, the court held that, under the 1973 policy, "property damage" – *i.e.*, "physical injury to tangible property" – results from the release of friable asbestos fibers from the insulation causing damage to the contents of the building. 144 Ill. 2d at 75-76, 578 N.E.2d at 931-32. The district court observed that "the Illinois Supreme Court did not find that the installation itself was the [physical injury]" (A43) and that *Wilkin* "makes clear that property damage under the type of insurance contracts involved in the present case is the damage to the other parts of the structure or the contents of the structure." (A46) Accordingly, the district court concluded that Illinois law does not adopt the installation trigger advocated by Eljer.[2]

The district court further concluded that New York law comports with Illinois law on the trigger issue. The

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[2] In denying Eljer's post-judgment motion, the district court noted that a new, post-*Wilkin* appellate decision in *Bituminous Cas. Co. v. Gust K. Newberg Constr. Co.*, 218 Ill. App. 3d 956, 578 N.E.2d 1003 (1st Dist. 1991), also supports the rejection of the installation trigger advocated by Eljer. In *Bituminous*, the Illinois Appellate Court held that installation of a defective heating, ventilation and air conditioning system – like installation of the Eljer plumbing systems here – did not constitute "property damage" when there was no "physical detrimental effect" to the building. 218 Ill. App. 3d at 966, 578 N.E. 2d at 1010.

pertinent New York authority cited by the district judge is *Greenlee v. Sherman*, 536 N.Y.S.2d 877 (App. Div. 1989), involving a claim against a heating contractor for damages resulting from a fire caused by defective installation of a furnace. The New York court rejected the contention that installation triggered coverage under a 1973 version CGL policy, since installation did not cause the requisite *physical* injury to tangible property. Instead, the court concluded that the policy in effect at the time of the installation provided no coverage, because the fire did not occur during the policy period: "[The insurer's] policy does not provide coverage for injury sustained after the expiration of the policy period as the result of a condition created during the policy period." *Id.* at 881.

The district judge also relied on the Eleventh Circuit's opinion in *Young v. Insurance Co. of North America*, 870 F.2d 610, 611-12 (11th Cir. 1989) (per curiam), which held that, under New York law, a CGL policy containing the 1973 definition of "property damage" did not provide coverage for a fire resulting from the negligent installation of a gas grill when that installation took place during the policy period but the fire did not occur until after expiration of the policy.

The Court Of Appeals Decision

On appeal, a divided panel of the United States Court of Appeals for the Seventh Circuit reversed the judgment of the district court. While conceding that the district court's construction of the insurance policies was one that comported with the "everyday," "commonsensical," and "ordinary-language" meaning of "physical injury," Judge

Posner's majority opinion rejects that construction. (A6-9) Dismissing the Illinois and New York decisions in this area as "unclear," the majority opinion instead adopts a construction consistent with Judge Posner's prior scholarly work (R. Posner, *Economic Analysis of Law* 95-96 (3d ed. 1986)), holding that "property damage" occurs at the time of installation where "[t]he expected failure rate [of a product is] sufficiently high to mark the product as defective – sufficiently high, as is alleged to be the case regarding the Qest plumbing system, to induce a rational owner to replace it before it fails, so likely is it to fail." (A14)

The stated bases for this holding are Judge Posner's conclusions concerning (i) the supposedly "illusory" coverage available under the policy as interpreted by the district court and (ii) the intent of the drafters of the 1973 CGL policy. As to the first issue, Judge Posner found, *without reference to any evidence whatever,* that the district court's construction of the "standard general liability policy issued by the American insurance industry provides what to an outsider at any rate appears to be largely though not completely illusory coverage in an important class of cases." (A9) Having so concluded, Judge Posner went on to examine the supposed intent of the drafters of the 1973 form policy, citing a variety of articles and pamphlets – none of which was prepared by the drafters. (A9-10)

The result of Judge Posner's own factual investigation is his finding that the installation trigger is "what the draftsmen of the Comprehensive General Liability Insurance policy *apparently* intended and what rational parties

to such a policy *would* intend in order to make the policy's coverage real and not illusory . . . . " (A11; emphasis supplied) Accordingly, the case was remanded for entry of a judgment reflecting the installation trigger as explained by Judge Posner. (A20)

Judge Cudahy dissented, noting: "The majority properly relies on the purpose of insurance: spreading risks. That purpose, however, does not extend to risks that were not bargained for ex ante." (A21) Judge Cudahy concluded that he was "not at all convinced that [the contracting] parties intended to refer to the *installation* of plumbing systems that would fail years later" when they contracted for insurance to cover "physical injury." (A21; emphasis in original) The Judge noted that "Eljer could have purchased other kinds of insurance that would have covered risks from installation – although we can safely assume that the costs of such insurance would have been higher." (A21) Judge Cudahy also disagreed with the majority's reading of the applicable cases, finding that *Wilkin* and other Illinois cases compelled the rejection of an installation trigger: "I do not agree with the majority that the Illinois courts have left this issue open." (A22)

REASON FOR GRANTING THE WRIT

THE DECISION BELOW CONTRAVENES THIS COURT'S PRIOR DECISIONS ON SUMMARY JUDGMENT AND APPELLATE FACTFINDING IN A CASE WHICH, ACCORDING TO THE COURT OF APPEALS, RESOLVES "A DIFFICULT AND IMPORTANT QUESTION" HAVING "NATIONAL SIGNIFICANCE."

The court of appeals' opinion is predicated on its findings concerning (i) the "illusory" nature of the coverage supposedly provided by the 1973 CGL policy as

interpreted by the district court and (ii) the intent of the draftsmen of the 1973 form CGL policy. Yet, these are issues on which the district court took no evidence. Instead, relying on its own speculation, and on secondary sources authored by persons lacking first-hand knowledge of the facts, the court of appeals made its own fact findings as follows:

- The policy as interpreted by the district court would provide "largely though not completely illusory coverage in an important class of cases." (A9)[3]

- "*There was no intent* to curtail liability [in the 1973 form CGL policy] in a case of physical touching as where a defective water system is installed in a house." (A10; emphasis supplied)

- Interpretation of "physical injury" to mean installation of a defective product is "what

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[3] With respect to coverage for this type of claim being "illusory," Liberty has defended the vast majority of cases against Eljer asserting claims related to the Qest system and has paid approximately $9,000,000 in indemnity amounts for them, which Liberty contends has exhausted the property damage limits in all but one of the policies it issued to Eljer under a leak-based trigger. This amount is subject to reallocation if an installation trigger is adopted. Under an installation trigger, Eljer may be required to reimburse Liberty for a portion of these indemnity payments because the installations occurred in a fewer number of years than did the leaks. Therefore, from Liberty's standpoint, a leak-based trigger could require it to pay more than an installation trigger. In light of this, the court of appeals' factual finding regarding the illusoriness of coverage is confusing, at best. *See infra*, pp. 15-17.

> the draftsmen of the Comprehensive General Liability Insurance policy *apparently* intended and what rational parties to such a policy *would* intend in order to make the policy's coverage real and not illusory . . . . " (A11; emphasis supplied)

These fact findings are not peripheral. They are the *ratio decidendi* of the court of appeals' decision in a multi-million dollar case. Judge Posner stated as much in concluding that "the drafting history of the property-damage clause, and the probable understanding of the parties to liability insurance contracts, persuade us that the incorporation of a defective product into another product inflicts physical injury in the relevant sense on the latter at the moment of incorporation – here, the moment when the defective Qest systems were installed in homes." (A20)

A. The Court of Appeals Decision Contravenes the Holding of *Fountain v. Filson*, 336 U.S. 681 (1949), Restricting the Power of Courts of Appeals To Enter Summary Judgments.

The decision of the court of appeals violates established procedure and standards for the granting of summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure. Rule 56 permits judgment to be entered only upon a determination that "there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." In this case, the court of appeals has in effect ordered entry of summary judgment in Eljer's favor, even though the court identified issues of material fact that were not

before the district court. Having identified these issues of material fact, the court of appeals disposed of the case summarily, without making any determination as to whether these facts were disputed.

Whether there was a genuine dispute as to these facts could not be determined from the district court record. Neither party had addressed these issues before the district court, because there the issue of policy construction was treated as a question of law to be decided based on the language of the policy and the prior decisions construing similar language.

Years ago, this Court ruled, in a diversity case involving $6,000, that when a court of appeals reverses a district court's summary judgment, and holds that the case needs to be decided on the basis of factual issues not presented to the district court, the court of appeals must remand the case to the district court for further proceedings. In *Fountain v. Filson*, 336 U.S. 681 (1949), the district court's summary judgment determined that New Jersey realty acquired by the defendants was not subject to a resulting trust in favor of plaintiffs. On appeal, the United States Court of Appeals for the District of Columbia Circuit decided that plaintiff was entitled to recover a damage judgment, even in the absence of a trust. Based upon its own examination of depositions, the D.C. Circuit concluded that defendants owed a monetary obligation to plaintiff. So, the D.C. Circuit directed the district court on remand to enter judgment for $6,000 in favor of plaintiff.

This Court reversed, noting that "the order was made on appeal on a new issue as to which the opposite party

had no opportunity to present a defense before the trial court." The Court went on to state that:

> Summary judgment may be given, under Rule 56, only if there is no dispute as to any material fact. There was no occasion in the trial court for Mrs. Fountain to dispute the facts material to a claim that a personal obligation existed, since the only claim considered by that court on her motion for summary judgment was the claim that there was a resulting trust. When the Court of Appeals concluded that the trial court should have considered a claim for personal judgment it was error for it to deprive Mrs. Fountain of an opportunity to dispute the facts material to that claim by ordering summary judgment against her.

Id. at 683.

Following *Filson,* the D.C. Circuit has more recently explained the controlling principle as follows:

> When the parties have not even been notified that an issue will be considered by the court at the only point when they may submit factual affidavits – the trial level – then there is every likelihood that they have been denied the full opportunity to present the applicable facts. Unless the new issue uncovered by the appellate court was one which was clearly framed by the proceedings below so that the parties had a legitimate chance to submit all relevant materials and argue their implications, it is clearly unjust for the appellate court to direct the issuance of summary judgment on a new issue raised *sua sponte* on appeal.

Ramirez v. Weinberger, 745 F.2d 1500, 1537 (D.C. Cir. 1984), *cert. granted, vacated on other grounds*, 471 U.S. 1113 (1985).

In the instant case, the court of appeals employed a procedure directly violating *Filson*, in a matter involving not $6,000, but millions of dollars. The insurers are entitled to have the matter remanded to the district court for a determination of whether there is a genuine issue of material fact with respect to the factual questions determined *de novo* by Judge Posner.

B. The Court of Appeals Decision Contravenes the Holding Of *Icicle Seafoods, Inc. v. Worthington*, 475 U.S. 709 (1986), Restricting the Power of the Courts of Appeals To Make Findings of Fact.

In addition to flouting Rule 56, the appellate factfinding here contravenes the policies underlying Rule 52 of the Federal Rules of Civil Procedure. Rule 52(a) provides that "[f]indings of fact . . . shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses." While Rule 52 does not directly address the procedures to be followed by the court of appeals when it believes that issues of fact pertinent to the outcome have not been addressed by the district court, this Court has stated that the policies underlying the rule require a remand for factfinding by the district court.

In *Icicle Seafoods, Inc. v. Worthington*, 475 U.S. 709 (1986), the issue was how seamen spent their working time on a boat. The district court had made no findings on the issue. The court of appeals made its own findings. This Court vacated and remanded for factfinding by the

district court. "If the Court of Appeals believed that the District Court had failed to make findings of fact essential to a proper resolution of the legal question, it should have remanded to the District Court to make those findings". *Id.* at 714. *Accord, San Diego Gas & Elec. Co. v. City of San Diego,* 450 U.S. 621, 632 (1981) ("The logical course of action for an appellate court that finds unresolved factual disputes in the record is to remand the case for the resolution of those disputes."); *Pullman-Standard v. Swint,* 456 U.S. 273, 291 (1982) ("When an appellate court discerns that a district court has failed to make a finding because of an erroneous view of the law, the usual rule is that there should be a remand for further proceedings to permit the trial court to make the missing findings.").

This principle is firmly anchored in the "clearly erroneous" standard of review embodied in Rule 52(a). "The reviewing court oversteps the bounds of its duty under Rule 52(a) if it undertakes to duplicate the work of the lower court." *Anderson v. Bessemer City,* 470 U.S. 564, 573 (1985). In other words, under the clearly erroneous standard, "appellate courts must constantly have in mind that their function is not to decide factual issues *de novo.*" *Zenith Radio Corp. v. Hazeltine Research, Inc.,* 395 U.S. 100, 123 (1969). *Accord, Amadeo v. Zant,* 486 U.S. 214, 228 (1988) ("The district court's lack of precision, however, is no excuse for the court of appeals to ignore the dictates of Rule 52(a) and engage in impermissible appellate fact-finding.")

The Seventh Circuit's decision in this case defies this Court's *Icicle Seafoods* prohibition against *de novo* appellate factfinding. First, the court below decided *de novo*

that the district court's construction of the insurance policies would cause the coverage provided to become "largely though not completely illusory," even though no evidence at all had been presented on this subject to the district court, and even though Liberty Mutual had paid out over $9,000,000 on claims pursuant to the so-called "illusory coverage." (A9)

The issue of illusoriness could not possibly be resolved correctly without the presentation of evidence. Plain logic shows that the construction advocated by Eljer does not necessarily provide more coverage in the aggregate than that advocated by Liberty and Travelers and adopted by the district court. In other words, the installation trigger proposed by Eljer does not necessarily maximize a manufacturer's insurance coverage. Under a chronological scenario different from that presented here, adoption of a leak-based trigger, not an installation trigger, would maximize coverage. For instance, if Eljer had obtained CGL coverage only after it had completed installation of the Qest systems, or if it had substantially increased the limits of its coverage after it completed installation, an installation trigger would be less desirable for Eljer than a leak-based trigger. The same conclusion would be reached for companies whose products were installed in the 1950's or 1960's, when the amounts of coverage were relatively small, but whose products have failed in recent years, when coverage amounts typically are much larger.

If, as Judge Posner concludes, Illinois and New York law prohibit a construction of an insurance policy which would cause coverage to be "largely though not completely illusory" for a given class of cases, then there was,

at a minimum, a fact question for the district court on whether the trigger adopted by the district court caused the coverage to become illusory. Resolution of this question would require consideration of actuarial evidence, which was never presented, because the issue of illusoriness was never before the district judge.

The court of appeals also made findings about "what the draftsmen of the Comprehensive General Liability Insurance policy *apparently* intended" (A11), even though no evidence was taken by the district court concerning the drafters' intent. The "drafting history" materials cited by Judge Posner on the issue of intent are not primary sources that reflect the thoughts of the drafters of the form policy. Rather, the materials contain the speculation of legal and industry commentators concerning the meaning of "physical injury." Nothing in any of the "historical" materials cited by the court suggests that the authors of the articles participated in or had any first-hand knowledge of the 1973 revisions to the CGL policy.[4]

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[4] W. Obrist, *The New Comprehensive General Liability Insurance Policy: A Coverage Analysis* 5 (Defense Research Institute, Inc. 1966) (Mr. Obrist was the Assistant Manager of the Syracuse branch of General Accident Group); G. Tinker, *Comprehensive General Liability Insurance – Perspective and Overview*, 25 Fed. of Ins. Counsel Q. 217 (1975) (Mr. Tinker was an associate general counsel for Kemper Insurance Companies); F. Bardenwerper & D. Hirsch, *General Liability Insurance - 1973 Revisions* 3-5 (Defense Research Institute, Inc. 1974) (Mr. Bardenwerper was the Assistant Research Director for the Defense Research Institute, Mr. Hirsch was an attorney with Utica Mutual Insurance Company and Alfred Reichenberger, who wrote the section of the pamphlet cited by Judge Posner, was a staff attorney with Utica Mutual Insurance Company).

Indeed, some of the publications cited by the court as "historical" materials do not even have named authors and appear to be merely unofficial guides to understanding the CGL policy. See Society of Chartered Prop. and Cas. Underwriters, *1973 CGL Changes* 9 (1971); *Guide to Liability Insurance* 4 (Rough Notes Co. 1973).

Furthermore, the commentary cited does not even appear to support the court of appeals' conclusion as to the drafters' intent. Indeed, one of the articles on which the majority relies actually supports the insurers' argument that the word "physical" was inserted in the 1973 definition of "property damage" to make it clear that intangible injuries – such as the diminution in value of a home after installation but before failure of defective pipes – are *not* covered. G. Tinker, *Comprehensive General Liability Insurance – Perspective and Overview,* 25 Fed. of Ins. Counsel Q. 217, 232-33 (1975) (insertion of the word "physical" clarifies that "non-physical or intangible" injuries are not covered). Additionally, the court wholly ignored the commentators that were cited by the insurers who have concluded that incorporation alone is not "physical injury" under the 1973 policy. K. Abraham, *Environmental Liability Insurance Law: An Analysis of Toxic Tort and Hazardous Waste Insurance Coverage Issues* 86-87 (1991); J. Arness & R. Eliason, *Insurance Coverage for "Property Damage" in Asbestos and Other Toxic Tort Cases,* 72 Va. L. Rev. 943, 967 (1986).

Finally, as Judge Cudahy correctly observes in his dissenting opinion, "the relevant parties are Eljer, Liberty Mutual and Travelers – not the drafters of the CGL standard policy." (A21) It is their intent in entering into the relevant insurance contracts that governs the result here –

not the intent of the drafters of the form policy. And there is not a shred of evidence in the record here of the contracting parties' intent, because both sides argued in the district court that the policy language was unambiguous and could be construed without reference to extrinsic evidence of intent.

In sum, if the meaning of "physical injury to tangible property" must be decided according to the intent of the contracting parties, or the drafters of the 1973 CGL policy, then the determination of that intent creates an issue of fact. Since neither party made an issue of intent in the district court, there was no evidentiary record on the issue. The court of appeals plainly violated *Icicle Seafoods* by making its own finding of facts, when there was no competent evidence in the record to support such findings.

C. The Court of Appeals Decision – Predicated On Improperly Found Facts – Reaches A Result At Odds With Three Sister Courts of Appeals and Numerous State Appellate Courts On an "Important" Issue of "National Significance."

The result of the improper procedure followed by the court of appeals is a decision on an "important" question having "national significance" (A1-2) which is contrary to almost every other state and federal opinion on the subject. Indeed, three sister United States Courts of Appeals have concluded that the 1973 CGL policy language does *not* support an installation trigger.

The United States Courts of Appeals for the First, Ninth and Tenth Circuits have all considered the issue of

whether incorporation of defective material into a product – without more – constitutes "physical injury to tangible property" under the 1973 form policy. All of these courts have concluded, like the district court here, that mere incorporation does not constitute "physical injury."

Most recently, in *New Hampshire Ins. Co. v. Vieira*, 930 F.2d 696 (9th Cir. 1991) (California law), the Ninth Circuit considered whether a claim against a contractor for failure properly to install drywall in a housing project stated a claim for "property damage" where the only damage alleged was diminution in value due to increased fire risk. The court of appeals adopted Judge Peckham's opinion, which held, like the district court opinion in this case, that no claim for "property damage" was stated. The court expressly determined that cases construing the 1966 language, which lacked reference to "physical" injury in the definition of property damage, were inapposite to construction of the 1973 language. *Id.* at 698-99. The court went on to adopt the reasoning of the Minnesota Supreme Court's opinion in *Federated Mut. Ins. Co. v. Concrete Units, Inc.*, 363 N.W.2d 751 (Minn. 1985), which held that diminished property value due to incorporation of defective concrete did not constitute "property damage" for purposes of the 1973 CGL policy. 930 F.2d at 700-01.

Similarly, in *Hartford Acc. & Indem. Co. v. Pacific Mut. Life Ins. Co.*, 861 F.2d 250 (10th Cir. 1988) (Oklahoma law), the Tenth Circuit considered whether an umbrella policy containing a definition of property damage identical to the 1973 CGL policy provided coverage for diminution in a building's value caused by the insured's installation of a defective glass curtain wall system. Relying on, *inter alia*, the Minnesota Supreme Court's opinion in *Federated*,

the Tenth Circuit held that such diminution in value does not constitute "property damage": "The definition of property damage incorporated into the standard CGLP form by the 1973 revision and found in the umbrella policy here, was intended to preclude coverage for intangible injuries such as diminution in value." *Id.* at 254.

The Tenth Circuit's conclusion about the addition of the word "physical" to the definition of "property damage" is strongly supported by the First Circuit's opinion in *American Home Assurance Co. v. Libbey-Owens-Ford Co.*, 786 F.2d 22 (1st Cir. 1986) (Massachusetts law), where the court provided the following explanation about the difference between the definition of "property damage" in the 1966 and 1973 CGL policies:

> In cases in which courts have interpreted more recent policies in which property damage is defined as "physical" injury to tangible property, such courts have held that intangible damages, such a diminution in value, are not considered property damage. . . . The critical difference in policy language is the result of a 1973 revision of the Comprehensive General Liability Policy, used by most insurance companies, *which expressly added the modifier "physical" injury to the definition of "property damage" in order to restrict recovery for intangible losses.* Under this policy language, some physical injury to tangible property must be shown in order to trigger coverage.

Id. at 25 (citations omitted; emphasis supplied).

The leading state court opinions on the subject are to the same effect, rejecting an installation trigger. *See, e.g., Federated Mut. Ins. Co. v. Concrete Units, Inc.*, 363 N.W.2d

751 (Minn. 1985); *Millers Mut. Fire Ins. Co. v. Ed Bailey, Inc.*, 647 P.2d 1249 (Idaho 1982); *Wyoming Sawmills, Inc. v. Transp. Ins. Co.*, 578 P.2d 1253 (Or. 1978).

Judge Posner's only comment on all this contrary authority is that the decisions in *Vieira* and *Libbey-Owens-Ford Co.* reached their conclusions "without examining the considerations – the drafting history of the provision and the purposes of the insurance – that argue against such a reading." (A19)

If those are indeed the considerations that should drive construction of the insurance policy, then – in a case of "national significance" – the insurers are entitled to have those factual questions determined in accordance with the summary judgment procedure promulgated in Rule 56 of the Federal Rules of Civil Procedure and to have factfinding conducted in accordance with Rule 52 by the trier of fact. The procedure followed by the court of appeals here was fundamentally unfair in depriving the insurers of their opportunity to be heard before facts were found against them.

CONCLUSION

For the reasons stated, petitioners respectfully pray that a writ of certiorari be granted, that the judgment of the court of appeals be reversed and that this case be remanded to the district court with appropriate instructions.

Respectfully submitted,

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APPENDIX A
IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Nos. 91-3203, 91-3251, 91-3298

ELJER MANUFACTURING, INCORPORATED,

Plaintiff-Appellant,

v.

LIBERTY MUTUAL INSURANCE COMPANY,

Defendant-Appellee,

and

TRAVELERS INDEMNITY COMPANY OF ILLINOIS,

Intervening-Defendant-Appellee.

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 88 C 3143 – **William T. Hart,** *Judge.*

ARGUED JUNE 3, 1992 – DECIDED AUGUST 14, 1992

Before CUDAHY, POSNER, and KANNE, *Circuit Judges.*

POSNER, *Circuit Judge.* The appeal and cross-appeals in this diversity suit bring before us a difficult and important question of insurance law, one that we must decide under Illinois law but that has nationwide significance because it involves the interpretation of language that

appears in the industry-wide standard-form policy known as Comprehensive General Liability Insurance. George H. Tinker, "Comprehensive General Liability Insurance – Perspective and Overview," 25 *Federation of Ins. Counsel Q.* 217, 218-21 (1975); *Abex Corp. v. Maryland Casualty Co.*, 790 F.2d 119, 121 (D.C. Cir. 1986). If a manufacturer sells a defective product or component for installation in the real or personal property of the buyer, but the defect does not cause any tangible change in the buyer's property until years later, can the installation itself nonetheless be considered a "physical injury" to that property? The defective product or component in such a case is like a time bomb placed in an airplane luggage compartment: harmless until it explodes. Or like a silicone breast implant that is harmless until it leaks. Or like a defective pacemaker which is working fine now but will stop working in an hour. Is the person or property in which the defective product is implanted or installed physically injured at the moment of implantation or installation – in a word, incorporation – or not until the latent harm becomes actual?

The product at issue is a plumbing system, called "Qest," that appellant Eljer's U.S. Brass subsidiary manufactured and sold to plumbing contractors all over the United States between 1979 and 1986 (some have continued to be sold for installation in mobile homes, but we can ignore that detail). Between a half million and three-quarters of a million Qest systems were installed in houses and apartments, invariably behind walls or below floors or above ceilings, so that the repair or replacement of the unit requires breaking into walls, floors, or ceilings. Within a year after the first units were sold and installed,

complaints about leaks began coming in and the first products-liability lawsuit was brought against U.S. Brass in 1982. By 1990 several hundred additional suits had been filed, some of them class actions, involving altogether almost 17,000 of the systems; and it is estimated that ultimately 5 percent of the total number of Qest systems ever sold will have failed in circumstances likely to provoke a tort suit. Eljer reckons U.S. Brass's potential tort liability in the hundreds of millions of dollars, most of which Eljer hopes to recover from insurers – but only if it wins this case.

The tort claims are of two basic types – leak and nonleak – with the second requiring further subdivision:

(1) Claims that the system leaked, and caused water damage to the homeowner or forced him to repair or replace the system or deprived him of the use of his property (the leak, or the process of repair or replacement, may have made the home temporarily uninhabitable) or reduced the value of his home; or inflicted more than one of these harms.

(2) Claims that although the system has not yet leaked, (a) the value of the property in which it was installed has fallen as a result of the danger that the system may leak in the future, or the homeowner has as a precaution against that danger incurred the expense of replacing the system without waiting for it to leak; (b) the homeowner has been deprived of the use of his property while his Qest system was being replaced; (c) merely the ominous presence of the nonleaking, but perhaps some day destined to leak, Qest has deprived the homeowner of the use of his home (he's afraid to turn on the water) –

as when a building is evacuated in response to a bomb threat.

Liberty Mutual, the principal defendant, issued a series of annual Comprehensive General Liability Insurance policies to Eljer covering the years 1979 through 1988. Travelers, the other defendant, provided excess coverage for Eljer between 1982 and 1986. The policies cover liability for "property damage" accidentally caused by Eljer or its subsidiaries, defined as "(1) physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or (2) loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence [defined, so far as relevant here, as an accident, including continuous or repeated exposure to conditions] during the policy period." This language was changed in the last three policies (covering 1986 through 1988), but, the parties agree, not materially.

Eljer brought this declaratory judgment suit to establish that the physical injury to the property of the buyer of a Qest system occurs when the system is installed in the buyer's house or apartment, not when it begins to leak or is replaced or is recognized to have reduced the value of the buyer's property. If this is right, essentially all the "property damage" inflicted by the defective systems occurred during the years in which Liberty's insurance policies were in force, because those were the years in which the systems were sold and installed. Liberty, however, contends that with respect to Eljer's liability (actually U.S. Brass's liability, but we can disregard that detail too) for leaking systems, the "property damage" to

which the policies refer does not occur until the system leaks. If it hasn't leaked, but has been replaced in anticipation of its proving defective, or the value of the home has diminished, or the homeowner has lost the use of his property because he's afraid to use the plumbing, then, provided at least one other Qest system somewhere else has leaked, there is "property damage" as of the time when the homeowner realizes that the Qest is reducing the value of his home and (or) must be replaced. Liberty argues in the alternative that in the nonleaking case the physical damage occurs when the homeowner replaces his Qest system, since the process of removing the old system causes unquestioned damage to the house.

Many of the leaks upon which tort claims against Eljer are based did not occur until after the expiration of Liberty's last insurance policy at the end of 1988. And many people did not realize till then that their Qest systems were potentially defective and reducing the value of their homes and ought to be replaced and maybe the home not used until it was replaced because the water should be shut off immediately as a precaution. So if the insurance companies' arguments prevail, Eljer will not be able to shift a substantial part of the burden of the tort claims against it to Liberty – or to Travelers, whose coverage expired even sooner.

The district judge agreed with the insurance companies that property damage within the meaning of the Comprehensive General Liability Insurance form contract does not occur upon installation of the defective system, except in the case of claims for loss of use where there is no leak (categories (2)(b) and (2)(c) in our typology). In the case of claims that arise from leaks, property damage

occurs, in the district judge's view, when the leak occurs, while in the case of claims for the cost of repair or replacement incurred in anticipation of a leak it occurs at the time of repair or replacement. Eljer challenges these rulings. Liberty and Travelers cross-appeal, arguing mainly that the judge should not have ruled on loss of use claims when there is no leak, because the issue was not presented to him. The insurance companies are correct. Eljer failed to develop evidence or argument concerning this rather esoteric category of claims. It is not even clear that any claims of type (2)(c) have been or will be lodged against it – for how many people will vacate their home because they're afraid the pipes will leak unless the water is turned off? – in which event there might not even be an actual controversy between Eljer and its insurers over reimbursement for such claims. There are (2)(b) claims – loss of use of property incident to the replacement of a possibly defective Qest system. But because of the absence of evidence or argument concerning loss of use claims, the insurance companies, which may have had grounds for showing that such claims are within a policy exclusion, did not have a fair chance to defend themselves. *Burdett v. Miller*, 957 F.2d 1375, 1380 (7th Cir. 1992). Eljer is not entitled to a declaratory judgment concerning such claims.

The central issue in the case – when if ever the incorporation of one product into another can be said to cause physical injury – pivots on a conflict between the connotations of the term "physical injury" and the objective of insurance. The central meaning of the term as it is used in everyday English – the image it would conjure up in the mind of a person unschooled in the subtleties of

insurance law – is of a harmful change in appearance, shape, composition, or some other physical dimension of the "injured" person or thing. If water leaks from a pipe and discolors a carpet or rots a beam, that is physical injury, perhaps beginning with the very earliest sign of rot – the initial contamination (an important question in asbestos cases, as we shall see). The ticking time bomb, in contrast, does not injure the structure in which it is placed, in the sense of altering the structure in a harmful, or for that matter in any, way – until it explodes. But these nice, physicalist, "realistic" (in the philosophical sense) distinctions have little to do with the objectives of parties to insurance contracts. The purpose of insurance is to spread risks and by spreading cancel them. Most people (including most corporate executives) are risk averse, and will therefore pay a premium to avoid a small probability of a large loss. Once a risk becomes a certainty – once the large loss occurs – insurance has no function. The last point at which a Qest plumbing system has an insurable risk of being defective and causing harm is when it is installed. When it starts to leak is too late; the risk has turned into a certainty and cannot be spread by being insured. It may also be too late when so many other Qest systems have failed that the unknowable risk has become a statistical certainty (or nearly so). For the individual homeowner there is still uncertainty as to whether and when his Qest will leak, so he may still be able to buy insurance against such an eventuality, though the premium will be very high because the risk is very great. For Eljer, however, which is liable for all the leaks traceable to the defectiveness of the system (as distinct from mistakes in installation, or other causes for which

Eljer is not responsible), the pooling of the risks of the individual homeowners has produced a near certainty of a loss in excess of $100 million. How much in excess no one yet knows, and this leaves some room for insurance. But we are told that Eljer has had no primary liability coverage since the last Liberty policy expired at the end of 1988 and no excess coverage since the last Travelers policy expired at the end of 1986.

It would be an overstatement to say that the insurance policies which Eljer bought from the defendants had *no* value unless property damage is deemed to occur in the policy year in which the system is installed rather than in the policy year – more likely post-policy year – in which it fails or is so likely to fail that the prudent homeowner replaces it (perhaps vacating the home until it is replaced) or the market writes down the value of the home to reflect the risk of the system's failing and causing water damage and loss of use. Some systems malfunctioned in the year of installation; there was therefore been some payout under the insurance policies. And, because of limited liability, corporations have less incentive to buy insurance than private individuals do, David Mayers & Clifford W. Smith, Jr., "On the Corporate Demand for Insurance," 55 *J. Bus.* 281 (1982); maybe limited coverage for modest premiums was all Eljer wanted or bought. But the defendants make nothing of the special character of the corporate insurance market – nor is it clear just how special it is, given risk aversion by executives and other employees, and the costs of bankruptcy (*id.* at 283-85) – instead treating this case as if Eljer had been an individual who had been seeking liability insurance. In these circumstances we should not be quick to assume that the

standard general liability policy issued by the American insurance industry provides what to an outsider at any rate appears to be largely though not completely illusory coverage in an important class of cases. *Sears, Roebuck & Co. v. Reliance Ins. Co.*, 654 F.2d 494, 499 (7th Cir. 1981); *Keene Corp. v. Ins. Co. of North America*, 667 F.2d 1034, 1046-47 (D.C. Cir. 1981); *Hancock Laboratories, Inc. v. Admiral Ins. Co.*, 777 F.2d 520, 525 (9th Cir. 1986).

Nor are literal interpretations, which assume that words or phrases are always used in their ordinary-language sense, regardless of context, the only plausible interpretations of contractual language, especially when the contract is between sophisticated business entities. We should at least ask what function "physical injury" might have been intended to perform in a comprehensive general liability policy beyond just drawing a common-sensical, lay person's, ordinary-language distinction between physical injury and physical noninjury.

Apparently the term was intended to distinguish between *physical* and *nonphysical* injuries rather than to distinguish between *injuries* and *noninjuries*. The 1966 version of the General Comprehensive Liability Insurance policy form had defined "property damage" as "injury to or destruction of tangible property." Most courts, in apparent harmony with the drafters' intentions, Willard J. Obrist, *The New Comprehensive General Liability Insurance Policy: A Coverage Analysis* 7, 17 (Defense Research Institute, Inc. 1966), gave the term "injury" in the new definition a broad interpretation. *Elco Industries, Inc. v. Liberty Mutual Ins. Co.*, 90 Ill. App. 3d 1106, 1109-10, 414 N.E.2d 41, 45 (1980). Some, however, excluded injuries in which there was no physical contact between the injurer and the

property injured by him. (*Sola Basic Industries, Inc. v. United States Fidelity & Guaranty Co.*, 90 Wis. 2d 641, 280 N.W.2d 211 (1979), reviews the case law.) For example, if a manufacturer of construction cranes sold a defective crane which collapsed in front of a restaurant, blocking access to it and thereby impairing the restaurateur's income, and the restaurateur sued the manufacturer and recovered a judgment, the manufacturer's liability insurer might not have to pay, because the blocking of access might not be considered an injury to tangible property. Tinker, *supra*, at 232. To allay doubts on this score by sharpening the aim of the 1966 definition, the insurance industry's committee charged with updating the Comprehensive General Liability Insurance policy form redid the definition in 1973, producing the two-part definition that we quoted earlier from Liberty's policies. The second part, which is new, explicitly covers the injury inflicted by our hypothetical crane manufacturer – a "loss of use of tangible property which has not been physically injured or destroyed." The first part of the new definition is the old definition with "physical" prefixed to "injury" to distinguish the two parts. Both cover injury, but the second part covers injury which is not "physical" because there is no physical touching of the tort victim's property. Society of Chartered Property and Casualty Underwriters, *1973 CGL Changes* 9 (1971); Fred L. Bardenwerper & Donald J. Hirsch, *General Liability Insurance – 1973 Revisions* 11, 32 (Defense Research Institute, Inc. 1974); *Guide to Liability Insurance* 4 (Rough Notes Co. 1973). There was no intent to curtail liability in a case of physical touching, as where a defective water system is installed in a house.

We can now see more clearly that two senses of "physical injury" are competing for our support. One, which the insurers want us to adopt, is an injury that causes a harmful physical alteration in the thing injured. The other, which is what the draftsmen of the Comprehensive General Liability Insurance policy apparently intended and what rational parties to such a policy would intend in order to make the policy's coverage real and not illusory, is a loss that results from physical contact, physical linkage, as when a potentially dangerous product is incorporated into another and, because it is incorporated and not merely contained (as a piece of furniture is contained in a house but can be removed without damage to the house), must be removed, at some cost, in order to prevent the danger from materializing. There is an analogy to fixtures in the law of real and personal property – improvements to property that cannot be removed without damaging it. See, e.g., UCC § 9-313. In effect, we are being asked to choose between "*physical* injury" and "physical *injury*."

Human beings give structure to their experience – cut the world of perception up into usable slices – through language, in accordance with the needs and interests of the moment. For many purposes the distinction between touching and altering is important; if two automobiles collide, it makes a big difference whether they merely touch each other or dent each other. For other purposes, other distinctions are more important, such as that between harms from touching, whether or not some harmful physical change ensues, and harms from other interferences with valued interests. Battery is a tort of touching, and, provided the touching is unpermitted and

offensive, the fact that the victim was not bruised or wounded goes only to the issue of damages. Assault is not a tort of touching – it becomes battery if the assailant touches his victim, as distinct from making a merely threatening gesture. Physical contact, not physical injury in the layman's sense, distinguishes the two torts. W. Page Keeton *et al., Prosser and Keeton on the Law of Torts* §§ 9-10, at pp. 39-46 (5th ed. 1984).

Within the class of unintentional torts, too, the distinction between touching and not touching is often made. Under traditional tort law, if you hit a bridge and put it out of commission, you are liable to the owner of the bridge but not to merchants who lose business because customers cannot reach them with the bridge down. *Rickards v. Sun Oil Co.*, 23 N.J. Misc. 89, 41 A.2d 267 (1945). You have not touched the merchants or their property. The doctrine of "economic loss," illustrated by the *Rickards* case (and see *Petitions of Kinsman Transit Co.*, 388 F.2d 821, 825 n. 8 (2d Cir. 1968); *Barber Lines A/S v. M/V Donau Maru*, 764 F.2d 50 (1st Cir. 1985); Robert L. Rabin, "Tort Recovery for Negligently Inflicted Economic Loss: A Reassessment," 37 *Stan. L. Rev.* 1513 (1985)), makes touching a prerequisite to tort liability for damage to property and thus rules out loss-of-use claims by persons with whose property the tortfeasor had made no physical contact.

The evolution of the bipartite structure of the Comprehensive General Liability Policy may have been shaped by this distinction between physical and economic loss (a poor choice of words – all the losses for which tort victims sue are economic). At first the distinction was so ingrained in tort law that there was little

demand for liability insurance on the part of injurers who had not physically touched their victims, because such an injurer would have no liability against which to insure. The bar to this sort of liability weakened – though gradually, haltingly, and only in some jurisdictions – through an increasing recognition of exceptions. *Barber Lines A/S v. M/V Donau Maru, supra,* 764 F.2d at 55-56; *Union Oil Co. v. Oppen,* 501 F.2d 558 (9th Cir. 1974); *J'Aire Corp. v. Gregory,* 24 Cal. 2d 799, 598 P.2d 60 (1979); *People Express Airlines, Inc. v. Consolidated Rail Corp.,* 100 N.J. 246, 495 A.2d 107 (1985); Keeton *et al., supra,* § 129, at pp. 1001-02. The demand for insurance against liability for loss of use unaccompanied by physical injury in the traditional sense rose concomitantly. It is not surprising that a new definition of property damage – a definition that encompassed two forms of injury, one physical and one not – emerged, and that coverage was extended to the second.

We cannot be confident, given a sparse drafting history, that the evolution of the definition of property damage is, as we have just conjectured, a response to the changing vicissitudes of the economic-loss doctrine. Although the reference to the crane case suggests that it is, for accidents that cause merely delay are standard examples of the operation of the doctrine, *Petitions of Kinsman Transit Co., supra,* 388 F.2d at 825 n. 8, the timing is off. The cases we have cited for the gradual erosion of the doctrine were decided after the definitional changes, though they may have been anticipated before. It is not even clear that the suits against U.S. Brass for loss of the use of the property in which the Qest systems were installed are affected by that doctrine. The concern

behind it is with unanticipated plaintiffs and disproportionate liabilities, and the rubrics under which recovery is denied are duty and proximate cause. A homeowner who replaces a plumbing system that is likely to fail could be thought to be trying to mitigate the consequences of the supplier's having supplied a defective product, and thus to be curtailing rather than expanding liability. If so, however, denial of insurance coverage would be arbitrary; it would exploit the adventitious circumstance that a "physical injury" in the purely conventional sense of the word had not yet occurred.

All this may seem an aside, since these appeals (we have held) do not involve loss of use, but only physical injury. The significance of the loss of use provision, however, lies in what it tells us about the meaning of the physical injury provision. Whatever the precise function of the loss of use provision – whatever its precise relation to the economic loss doctrine – it was not added, and injury redescribed as physical injury, in order to curtail the preexisting insurance coverage for injury to tangible property. That coverage was and remains broad. Not promiscuously so. We do not think that every time a component part fails, the resulting injury can be backdated to the date of installation or incorporation. The expected failure rate must be sufficiently high to mark the product as defective – sufficiently high, as is alleged to be the case regarding the Qest plumbing system, to induce a rational owner to replace it before it fails, so likely is it to fail. That condition was satisfied. We believe that the coverage provided by Comprehensive General Liability Insurance encompassed (loss of use to one side) the tort claims against U.S. Brass.

So far we have been discussing the case as if it had to be decided on the basis of first principles, and that is nearly true because the cases are unclear. The parties agree that New York law governs some of the policy years and Illinois law the rest, and they further agree that the relevant law of the two states is the same. The New York law on the question is particularly sparse. We know that the New York courts accepted the incorporation concept of property damage under the 1966 definition in the Comprehensive General Liability Insurance policy. *Sturges Mfg. Co. v. Utica Mutual Ins. Co.*, 37 N.Y.2d 69, 332 N.E.2d 319 (1975); *Marine Midland Services Corp. v. Samuel Kosoff & Sons, Inc.*, 60 App. Div. 2d 767, 400 N.Y.S.2d 959 (1977). But we have no cases interpreting the 1973 definition, the one at issue here. The closest are cases on negligent installation. *Greenlee v. Sherman*, 142 App. Div. 2d 472, 536 N.Y.S.2d 877 (1989); *Holmes Protection of New York, Inc.*, 152 App. Div. 2d 496, 543 N.Y.S.2d 459 (1989), and *Young v. Ins. Co. of North America*, 870 F.2d 610 (11th Cir. 1989) (per curiam) (applying New York law). *Young* is representative. The builder of a house installed a gas barbecue grill in the course of construction. The installation was negligent, resulting in a fire years later that destroyed the house, and the court held that physical damage within the meaning of the insurance policy occurred at the time of the fire, not of the installation. The analogy to our case is plain. But neither in *Young* nor in the other two cases did the court consider the incorporation theory of *Sturges* and *Kosoff* and whether it had survived the 1973 redefinition of property damage.

We get a little more help from the Illinois cases, although the parties spend too much time discussing

United States Fidelity & Guaranty Co. v. Wilkin Insulation Co., 193 Ill. App. 3d 1087, 550 N.E.2d 1032 (1989), aff'd, 144 Ill. 2d 64, 578 N.E.2d 926 (1991), where the issue was whether the installation of insulation containing asbestos in schools and other public buildings was property damage. The Illinois Appellate Court held that it was. Interpretation of the opinion is complicated by the fact that the case involved both policies that contained the 1966 definition of property damage and policies that contained the 1973 definition. As to the first, the court unambiguously held that the installation of the defective insulation (defective because it contained asbestos which might leak) was "injury to . . . tangible property." It then discussed whether it was also "physical injury" within the meaning of the first part of the 1973 definition, and here the opinion turns murky. The court begins by listing the cases on which the insurers rely. It distinguishes them at great length, implying that it rejects the insurers' argument. But later the court veers off, remarking, "Even assuming, *arguendo*, that the buildings had not sustained physical injury," the defendants may be liable under the second part of the 1973 definition. 193 Ill. App. 3d at 1097, 550 N.E.2d at 1038. In the course of distinguishing the insurers' cases the court notes the continuous release of asbestos fibers; and that is unlike the ticking time bomb case (or this case), where the defective product is completely dormant before the explosion (or leak). But the weight of this factor in the court's decision is unclear; the statement of facts does not mention the emission of asbestos fibers.

The Supreme Court of Illinois affirmed, but on the ground "that asbestos fiber *contamination* constitutes

physical injury to tangible property." 144 Ill. 2d at 75, 578 N.E.2d at 931 (emphasis added). The insurers in our case treat this as a tacit repudiation of the Illinois Appellate Court's incorporation theory of physical injury. And they point out that the Qest plumbing system does not "contaminate" the home in which it is installed until it starts to leak. But as the theory of the Illinois Appellate Court's decision is unclear, so is it unclear what if anything the supreme court thought it was repudiating; and of course the adoption of one ground need not imply the repudiation of an alternative ground. The fact of contamination made *Wilkin* an easier case than ours; it does not follow that the supreme court would decide the more difficult case another way.

The closest case to ours is *Marathon Plastics, Inc. v. International Ins. Co.*, 161 Ill. App. 3d 452, 514 N.E.2d 479 (1987). Marathon, the insured, sold pipes for installation in an underground water system. The pipes were defective, which caused the system to leak. The leaks caused no physical damage, but of course they impaired the operation of the water system, and Marathon was sued. The court held that Marathon was covered by its liability policy, because its tort liability was for inflicting property damage within the meaning of the 1973 definition. The court relied on earlier Illinois cases, notably *Elco Industries, Inc. v. Liberty Mutual Ins. Co., supra,* and was explicitly that the absence of physical injury in the ordinary sense to the water system was immaterial; it was enough that the leaks reduced the system's value. 161 Ill. App. 3d at 463, 514 N.E.2d at 485.

We can find no contrary authority in Illinois. The cases on which the insurers rely do not involve incorporation. The insurers place particular weight on *Bituminous Casualty Corp. v. Gust K. Newberg Construction Co.*, 218 Ill. App. 3d 956, 578 N.E.2d 1003 (1991), because it was decided after the Supreme Court of Illinois decided *Wilkin*. It is true that the insured lost in *Bituminous Casualty*, but we can find nothing in the opinion to suggest that the court thought the supreme court had repudiated the incorporation analysis of *Elco* and *Marathon*. The underlying tort suit was for the improper design, manufacture, and installation of the heating, ventilating, and air-conditioning system in the State of Illinois Building in Chicago. It was not an incorporation case because there was no suggestion that the system had reduced the value of the building or could not be removed without damage to the building – actually no one wanted it removed, only fixed. There is a danger, which the court was alert to resist, of stretching the concept of incorporation to the point where every defective product is deemed to injure some piece of tangible property, for almost every product is used in conjunction with something else. If the insured had won, a defective light bulb could be described as causing physical injury to the room in which it was flickering. The issue in *Bituminous Casualty* was not whether the incorporation doctrine is part of Illinois law; that was taken for granted, notwithstanding the supreme court's decision in *Wilkin*. The issue was the scope of the doctrine, and is not presented by this case. But we see that the word "physical" in the definition of property damage serves an important limiting purpose even if it is

not interpreted to require a change in the property with which the tortfeasor comes in contact.

That covers the Illinois cases, and since the parties agree that Illinois law is authoritative, there is no reason to look further – and not much to find there. It is true that several cases, illustrated by *New Hampshire Ins. Co. v. Vieira*, 930 F.2d 696 (9th Cir. 1991), and *American Home Assurance Co. v. Libbey-Owens-Ford Co.*, 786 F.2d 22, 25-26 (1st Cir. 1986), read the 1973 definition of property damage restrictively. But they do so without examining the considerations – the drafting history of the provision and the purposes of insurance – that argue against such a reading. So we doubt that the Illinois cases are mere sports likely to be swept away by the state supreme court. Of course we cannot be certain that that court, should it have a case like this, would not sweep aside the whole line of incorporation decisions of the appellate court. The U.S. Supreme Court frequently sweeps aside a line of considered decisions in the federal courts of appeals. E.g., *McNally v. United States*, 483 U.S. 350 (1987); see *id.* at 376 (dissenting opinion). Even when a state's intermediate appellate decisions are uniform, or at least reasonably so, as they are here, we are not bound by them. *Indiana Harbor Belt R.R. v. American Cyanamid Co.*, 916 F.2d 1174, 1176 (7th Cir. 1990) (dictum). But we do need, in such a case, a reason for predicting that the state's supreme court will reject the intermediate decisions, *West v. American Tel. & Tel. Co.*, 311 U.S. 223, 237-38 (1940); *Diesel Service Co. v. AMRAC Int'l Corp.*, 961 F.2d 635, 639 n. 3 (7th Cir. 1992); *Tippecanoe Beverages, Inc. v. S.A. El Aguila Brewing Co.*, 833 F.2d 633, 638-39 (7th Cir. 1987) – as we did in *Williams, McCarthy, Kinley, Rudy &*

Picha v. Northwestern National Ins. Group, 750 F.2d 619, 624-25 (7th Cir. 1984), but do not here. On the contrary, the drafting history of the property-damage clause, and the probable understanding of the parties to liability insurance contracts, persuade us that the incorporation of a defective product into another product inflicts physical injury in the relevant sense on the latter at the moment of incorporation – here, the moment when the defective Qest systems were installed in homes.

The judgment of the district court is reversed, and the case remanded for the entry of a judgment for the plaintiff that will be consistent with this opinion.

REVERSED AND REMANDED.

CUDAHY, *Circuit Judge*, dissenting. The majority holds that "physical injury to tangible property" occurs when a defective product is incorporated into a larger structure rather than when the product malfunctions, causing physical damage to the structure. The court's analysis is impressive. I remain somewhat dubious, however, about its ultimate conclusion regarding what the parties intended by the phrase "physical injury." The ultimate reason I feel compelled to dissent – respectfully, of course – is that I read the Illinois cases differently than the majority reads them.

There is immediately something counterintuitive about saying that physical injury has been done to a house in which a functioning plumbing system has been installed. Of course when we determine later (years later) that a good number of the systems will fail – five percent in this case – then perhaps there is a sense in which the "injury" was present from the moment of installation:

this is the majority's "ticking time bomb" metaphor. But is there *physical* injury? The majority believes that interpreting the phrase is all a matter of emphasis – "*physical* injury" versus "physical *injury*." In my view, the phrase must be interpreted as "*physical injury*," with both words given effect. The majority's account cannot give both words meaning at the same time. Something *physical* occurs when the plumbing is installed – but it is not injury; and we might say that there is *injury* (of a sort) when the plumbing is installed – but it is not physical.

But I am not one to get too bogged down in assertedly "plain" or "objective" language. The majority properly relies on the purpose of insurance: spreading risks. That purpose, however, does not extend to risks that were not bargained for ex ante. (When courts impose risks on insurers that were *not* paid for by the insured, other insureds will ultimately pay in the form of higher premiums.) The question, then, is what the parties contemplated when they contracted for insurance to cover "physical injury." It is worth noting in this regard that the relevant parties are Eljer, Liberty Mutual and Travelers – not the drafters of the CGL standard policy. I am not at all convinced that these parties intended to refer to the *installation* of plumbing systems that would fail years later. As counsel for Travelers explained at oral argument, Eljer could have purchased other kinds of insurance that would have covered risks from installation – although we can safely assume that the costs of such insurance would have been higher. *See, e.g., Qualls v. Country Mutual Ins. Co.*, 123 Ill. App. 3d 831, 462 N.E.2d 1288, 1291 (4th Dist. 1984) ("Finding coverage for the cost of replacing or

repairing defective work would transform the [CGL] policy into something akin to a performance bond."). Indeed, as Eljer's plumbing systems began to leak, its ordinary "physical injury" insurance premiums jumped, and Eljer was soon unable to afford the insurance. This is unfortunate for Eljer, and it may point to problems in the structure of insurance markets; but it does not support an argument that "physical injury" occurs at the point of installation instead of the point of physical failure.

Another difficulty with the majority's approach is its reliance on the indeterminate notion of a "defective" product to perform the function of the word "physical." In this case the Qest system's failure rate was five percent, so perhaps we could say that each system installed was "defective." But all products have *some* failure rate. If a product has a failure rate of one percent, or one-tenth of one percent, is it "defective" such that it caused "physical injury" when installed?

Most importantly, I do not agree with the majority that the Illinois courts have left this issue open. First, both the First District appellate court and the Illinois Supreme Court indicated in *United States Fidelity & Guaranty Co. v. Wilkin Insulation Co.*, 193 Ill. App. 3d 1087, 550 N.E.2d 1032 (1st Dist. 1989), *aff'd*, 144 Ill. 2d 64, 578 N.E.2d 926 (1991), that the "physical injury" definition of property damage in the 1973 CGL policy was narrower than the "injury" language in the 1966 policy. The appellate court noted that "there is an additional requirement of physical injury under the first prong of the [1973] definition," 550 N.E.2d at 1037, and the Illinois Supreme Court characterized the 1973 version as "the strictest definition of property damage," 578 N.E.2d at 931. Next,

the appellate court's analysis in Wilkin must be considered. In the crucial passage, the court distinguishes three cases that stand for the proposition that mere incorporation of a defective product does not result in "physical injury" as required by the policy definition. How does it distinguish them? It points to the peculiar character of the incorporated product in the case before it – asbestos – which does physical damage from the moment of installation:

> exposure to asbestos has been described as a *continuing physical harm* because of the continuous release of the friable asbestos fibers. . . .
>
> [I]ncorporation of the asbestos did result in injury to tangible property. The incorporation of the asbestos *physically altered* the property in such a manner so as to render the various structures harmful until abatement procedures may be undertaken.

550 N.E.2d at 1038 (emphasis added). The court then cites one of its earlier decisions, in which it held that the installation of asbestos constituted physical injury because it "contaminated the school buildings with asbestos fibers . . . [and] threatens a substantial and unreasonable risk of harm by releasing toxic substances into the environment. . . . " *Board of Education v. A, C & S, Inc.*, 171 Ill. App. 3d 737, 525 N.E.2d 950, 956 (1st Dist. 1988), *aff'd in relevant part*, 131 Ill. 2d 428, 546 N.E.2d 580 (1989). As the majority notes, the court's opinion is not a model of clarity. But it is clear enough that the court does not rely on mere incorporation of the asbestos into buildings; it emphasizes the physical contamination from the asbestos which begins at the point of installation.

If the appellate court's decision in *Wilkin* is not clear enough, the Illinois Supreme Court's opinion in that case is. There the court found "physical injury" to property only by virtue of the fact that the buildings and their contents were "contaminated by toxic asbestos fibers." 578 N.E.2d at 931-32. In the case before us, this "contamination" standard translates into a conclusion that there is no physical injury until the Qest system leaks. The majority suggests that the *Wilkin* court's use of the "contamination" approach does not imply a rejection of a different approach. There might be something to this point – except that it is belied by analysis later in the opinion. The court proceeds to consider whether there was an "occurrence," defined in relevant part as "an accident . . . which result[s] in property damage . . . neither expected nor intended from the standpoint of the insured." The insurance company had argued that Wilkin (the insured) "intentionally installed asbestos-containing products with knowledge of the products' threat to human health" and that the risk was therefore expected or intended from Wilkin's standpoint. The Illinois Supreme Court rejected the argument:

> Plaintiffs misread the definition of "occurrence" contained in the policies. Under this definition, it is the "property damage" which must be "neither expected nor intended from the standpoint of the insured." Therefore, *it is the contamination of the buildings and their contents* that must be neither expected nor intended by Wilkin. We have reviewed the underlying complaints and are unable to find any allegations that Wilkin "expected or intended" to contaminate the buildings and the contents therein with toxic asbestos fibers.

578 N.E.2d at 932 (emphasis added). The passage may seem innocuous at first, but in fact it reveals that the Illinois Supreme Court adopted the "contamination" theory of physical injury exclusively. The court thus held that mere installation (plus risk) does *not* constitute property damage (defined as physical injury), but that contamination does constitute property damage.

The majority notes that other decisions of the Illinois courts do not provide particularly clear guidance, and I agree. I must disagree, however, with the court's reading of these cases and the guidance that they do provide. The majority finds support in *Marathon Plastics, Inc. v. International Ins. Co.*, 161 Ill. App. 3d 452, 514 N.E.2d 479 (4th Dist. 1987), in which the Fourth District appellate court relied on two cases decided under the pre-1973 CGL standard policy to find that the installation of a defective water pipe system was property damage. On the other hand, in *Bituminous Casualty Corp. v. Gust K. Newberg Construction Co.*, 218 Ill. App. 3d 956, 578 N.E.2d 1003 (1st Dist. 1991), the First District appellate court held that the installation of a defective heating, ventilation and air conditioning (HVAC) system at the State of Illinois Center was *not* property damage. I cannot agree with the majority that *Bituminous Casualty* is not an incorporation case. It is difficult to imagine that such an HVAC system did not become an integral part of the building upon installation. Indeed, the construction company had alleged that "during the repair work, walls, ceilings and other portions of the building had to be removed and replaced or repaired." 578 N.E.2d at 1006. The court's refusal to find coverage under the policy turned on the fact that "only economic losses" – such as loss of value –

were alleged. *Id.* at 1008. The court held that mere installation of the defective HVAC system did not constitute property damage under the 1973 policy language ("physical injury") because "there is *no physical detrimental effect* to the State of Illinois Center. We do not find this case analogous to the toxic fibers permeating the school buildings in *Wilkin*." *Id.* at 1010 (emphasis added).

But *Bituminous Casualty* does seem to adopt an analysis that conflicts with *Marathon Plastics*. How should this conflict be resolved? I think that *Bituminous Casualty* should ultimately carry the day. First, it is the more recent case, decided just last year. Second, it discusses, and makes sense of, the *Wilkin* decisions. And third, the analysis contained in *Marathon Plastics* is questionable (especially after the *Wilkin* decisions). The *Marathon Plastics* court's reliance on pre-1973-policy incorporation cases is based on the premise that the new definition of property damage is "virtually identical" to the old one – a proposition not accepted by the *Wilkin* courts. Additionally, the court seems to forget that it is applying the *new* definition when it concludes: "Therefore, *even though no physical injury occurred* to the water system, we find that due to the diminution in value to the system caused by the leaks, property damage has occurred." *Marathon Plastics*, 514 N.E.2d at 485 (emphasis added). The court fails to make any attempt (unlike the majority's valiant and plausible effort) to fit the notion of installation into the definition of "physical injury."

Were we writing on a clean slate, I might well agree that "physical injury" occurs when a defective product is installed. The majority concludes that what we are writing on is something very close to a clean slate – and I

cannot say that that characterization is completely off the mark. But in the end I think the cases provide enough guidance to call for affirmance. Therefore, I reluctantly but respectfully dissent.

A true Copy:

Teste:

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Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

ELJER MANUFACTURING, INC., a Delaware corporation, and Successor in Interest to HOUSEHOLD MANUFACTURING, INC.,	)	
Plaintiff,	)	No. 89 C 3143
THE TRAVELERS INDEMNITY COMPANY OF ILLINOIS, and HIGHLANDS INSURANCE COMPANY,	)	
Intervening Plaintiffs,	)	
v.	)	
LIBERTY MUTUAL INSURANCE COMPANY, a Massachusetts corporation,	)	
Defendant.	)	

MEMORANDUM OPINION AND ORDER

This case is a declaratory judgment action concerning the issue of which of a series of insurance policies provides coverage for various claims against Eljer Manufacturing, Inc., the plaintiff in this action.[1] Presently pending

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[1] The corporation was originally known as Wallace Murray Corporation. Sometime prior to 1988, it changed its name to Household Manufacturing, Inc., which was the name of the corporation at the time this suit was filed. Household was incorporated in Delaware with its principal place of business in Illinois at the time the suit was filed. In April 1989, Household

are cross motions for summary judgment.[2] All parties agree that this case can be resolved on summary judgment by interpreting the language of the insurance policies, any remaining factual disputes being nonmaterial.

The parties have entered into a lengthy stipulation of facts. Many of those facts, however, are immaterial to the resolution of this case which requires only a general declaration as to the meaning of the insurance policies, not a specific determination as to which policy provides coverage for any particular claim. The basic facts are as follows.

This action was brought by Eljer in April 1988. Named as defendant was Liberty Mutual Insurance Company ("Liberty"), a Massachusetts corporation with its principal place of business in Massachusetts. Liberty issued a series of one-year insurance policies to Eljer that ran from January 1, 1979 to January 1, 1989. The four policies that covered calendar years 1979 through 1982 were issued in New York. The six policies that covered calendar years 1982 through 1988 were issued in Illinois. Five supplemental policies covering Texas operations and calendar years 1980 through 1985 were also issued. The first three were issued in New York and the latter two in Illinois. United States Brass Corporation ("U.S. Brass") is a subsidiary of Eljer and is a named insured under all of

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changed its name to Eljer Manufacturing, Inc. and moved its principal place of business to Texas. Hereinafter, plaintiff will be referred to as "Eljer," regardless of the time period involved.

[2] Intervenor Travelers' motion to supplement the record is denied. Newspaper articles containing purported admissions of a party are not admissible evidence.

the policies. In October 1988, Highlands Insurance Company ("Highlands"), a Texas corporation with its principal place of business in Texas, was permitted to intervene as a party plaintiff. In November 1988, Travelers Indemnity Company of Illinois ("Travelers"), an Illinois corporation with its principal place of business in Illinois, was permitted to intervene as a party plaintiff. Highlands provided Eljer with first level excess coverage for the years 1979 through 1981. Travelers provided Eljer with first level excess coverage for the years 1982 through 1986.

The parties agree that, despite a slight modification of policy language over the years, the same ruling should apply to all the policies. From 1979 through 1985, the policies contained the following language:

> The Company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of
>
> Coverage A. bodily injury or
>
> Coverage B. property damage to which this policy applies, caused by an occurence, . . .
>
> * * *
>
> "property damage" means (1) physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or (2) loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period.

* * *

"occurrence" means, (a) an accident, including continuous or repeated exposure to conditions, which results in "bodily injury" or "property damage" neither expected nor intended from the standpoint of the "insured". . . .

From 1986 through 1988, the policies contained the following language:

We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this policy applies. . . . This insurance applies only to "bodily injury" or "property damage" which occurs during the policy period. The "bodily injury" or "property damage" must be caused by an "occurence." The "occurence" must take place in the "coverage territory." . . .

* * *

"Property damage" that is loss of use of tangible property that is not physically injured shall be deemed to occur at the time of the "occurrence" that caused it.

* * *

"Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.

* * *

"Property damage" means:

a. Physical injury to tangible property, including all resulting loss of use of that property; or

b. Loss of use of tangible property that is not physically injured.

The primary policies for the years 1979 through 1986 limited property damage liability to $1,000,000 per occurrence and $2,000,000 aggregate. The 1987 and 1988 primary policies had general aggregate limits of $6,000,000.

From 1979 through 1986, U.S. Brass manufactured and sold the components comprising the Qest Qick/Sert II residential polybutylene system ("Qest System"), a plastic hot/cold pressure plumbing system for installation in site-built residential dwellings, including houses, apartment buildings, and condominiums. The Qest System still is used in mobile homes, but has not been warranted to be installed in site-built housing since December 31, 1986, U.S. Brass sold the Qest System to plumbing contractors who installed the systems at construction sites. U.S. Brass also provided special crimping tools used in installing the system, as well as special instructions for installing it. The Qest System was almost always installed behind walls and between floors and ceilings. Repair or replacement generally requires breaking through walls, floors, or ceilings. Approximately 500,000 to 750,000 housing units in the United States contain the Qest System and, as of September 1990, approximately 5% had reported failures of the system.

Lawsuits based on failures of the Qest System have been filed against Eljer in at least 20 different states. Claims in these lawsuits are predicated on theories of strict liability in tort, breach of warranty, negligence, gross negligence, misrepresentation and fraud, and various state deceptive trade practices statutes. Plaintiffs

allege that the Qest System is defective because subject to leaking. Plaintiffs seek to recover for damage to the housing structure, fixtures, or personal property caused by leaks, the cost of replacing the Qest System, relocations costs, diminution in the value of the residence, and/or mental anguish. In some cases, plaintiffs have filed suit prior to the occurrence of any leaks, seeking damages for the decreased value of the residence and/or the costs of repairing or replacing the plumbing system. The following causes of leaks have been alleged: inadequate installation instructions; using materials that degrade when exposed to chlorinated water used in residences; unsuitability of the system when hot water recirculates within it; improper design in using a crimp ring to join the fitting to a pipe; failure to test the system before offering it for sale; improper design of the Celcon fittings that are part of the system; defectively designed and manufactured crimping tools; impossibility of proper installation; improper design and manufacture of the crimp rings; and errors in manufacturing the component parts.

The dispute in the present case concerns coverage for the claims brought by homeowners or contractors based on failures of the Qest System. As of September 1990, approximately 200 lawsuits involving 16,700 housing units had been filed. Both Liberty and the excess carriers have been defending suits. Some of the cases have gone to trial and some have been settled. The present suit centers on the question of which policy period the individual claims should be assigned to. In 1988, Liberty informed Eljer that it had reached the limits of any applicable policy. Liberty, however, continued to defend the

suits and all four parties entered into an interim reimbursement agreement pending the outcome of this suit. The parties also reached a tentative settlement that Eljer and Liberty signed, but the settlement was not consummated because Travelers and Highlands never signed it. A case or controversy presently exists because Liberty denies that there is further coverage and the excess carriers deny coverage for certain years.

In a prior lawsuit between Eljer and Liberty, this court ruled that all the claims should be considered a single occurrence.[3] *See Household Manufacturing, Inc. v. Liberty Mutual Insurance Co.*, No. 85 C 8519 (N.D. Ill. Feb. 10, 1987), *reconsideration granted*, (Nov. 16, 1987). The parties agree that that ruling has no direct bearing on the present dispute. Although one occurrence, the parties agree that property damage can occur in different years and that Eljer is not limited to claiming $1,000,000 for a single occurrence, but can claim the full limit for each separate policy period in which property damage occurred. Eljer argues that property damage occurs when the Qest System was installed in a particular housing unit. Liberty argues that property damage occurs when leaks first occur or, in the non-leak claims, when the owner first becomes aware that the value of the residence has declined or that the plumbing system needs to be

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[3] In the prior suit, the dispute centered on a form of self-insured retention that Eljer had. The computation of that retention differed if all claims were one occurrence instead of multiple occurrences under the policies.

replaced. Travelers argues that the property damage occurs on the date of the first leak.[4]

If Eljer's theory is accepted, all claims will have occurred from 1979 to 1986, the last year in which the Qest System was installed in residences other than mobile homes. If Liberty's or Travelers' theory is accepted, then Eljer may be afforded less coverage. Using the appearance of leaks and awareness of problems as the trigger date pushes many claims beyond the year of installation of the system. Thus, under the insurers' theories, claims in the early years of sales may be less than the limit of Liberty's policies. Of more concern to Eljer, however, is that under the insurers' theories, much of the property damage would not be considered to have occurred until after installation ceased in 1986. Eljer's excess coverage ended in 1986 and it has no coverage whatsoever after January 1, 1989.

Before turning to the merits of this case, a jurisdictional question must be considered. In August 1988, while Eljer was still a citizen of Illinois, Highlands and Travelers moved to intervene. Both intervenors represented that they were plaintiff-intervenors and their complaints only named Liberty as a defendant, not Eljer as well. It was assumed that the intervenors designated themselves as plaintiffs because they wanted Liberty to

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[4] Highlands has not moved for summary judgment. Its claims, however, cannot be separated from those of the other parties. The declaratory judgment that is granted as a result of the summary judgment motions will resolve all the issues in this case. Therefore, Highlands has implicitly agreed to rely on the briefs filed by the other parties.

pay a greater amount of the claim before they were obliged to cover the excess. However, it is now clear that Travelers'[5] interest is and was consistent with Liberty's interest. Both want the claims to be pushed to a later period in time beyond the dates covered by the policies they have issued to Eljer. Thus, both argue similar theories for determining the date of the occurrence and both are aligned against Eljer on the motions for summary judgment. Travelers should have been designated as an intervening defendant, not an intervening plaintiff. At the time of intervention, however, both intervening defendant Travelers and plaintiff Eljer were citizens of Illinois.

The rule has been that permissive intervention pursuant to Fed. R. Civ. P. 24 (b) requires an independent basis of jurisdiction, whereas intervention of right pursuant to Rule 24 (a) does not unless the intervenor is also an indispensable party under Rule 19 (b). *American National Bank & Trust Co. of Chicago v. Bailey*, 750 F.2d 577, 583 (7th Cir. 1984), *cert. denied*, 471 U.S. 1100 (1985); C.A. Wright, A. Miller, M.K. Kane, *Federal Practice & Procedure* § 1917 (2d ed. 1986). The continued vitality of the rule that intervention as of right does not require an independent jurisdictional basis, however, is brought into question in light of *Finley v. United States*, 490 U.S. 545 (1989), which narrowed the scope of ancillary jurisdiction over

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[5] Whether Highlands is a plaintiff or defendant is not of concern because, as of the time it intervened, its citizenship was diverse from all three of the other parties.

additional parties. *Compare City of Worcester v. HCA Management Co.*, 753 F. Supp. 31, 35-36 (D. Mass. 1990) (reexamining jurisdiction over third-party claims in light of *Finley*). In *Finley*, the Court indicated that ancillary jurisdiction over an additional party would be proper in some situations, including "when an additional party has a claim upon contested assets within the court's exclusive control or when necessary to give effect to the court's judgment." 490 U.S. at 551.

If timely application is made, Rule 24 (a) (2) provides for intervention as of right "when the applicant claims an interest relating to the property or transaction which is the subject of the action and the applicant is so situated that the disposition of the action may as a practical matter impair or impede the applicant's ability to protect that interest, unless the applicant's interest is adequately represented by existing parties." Thus, four elements must be satisfied: "(1) timely application; (2) an interest relating to the subject matter of the action; (3) potential impairment, as a practical matter, of that interest by the disposition of the action, and (4) lack of adequate representation of the interest by the existing parties to the action." *Meridian Homes Corp. v. Nicholas W. Prassas & Co.*, 683 F.2d 201, 203 (7th Cir. 1982).

The timeliness requirement is satisfied. Given the "following form" nature of the excess coverage, it is also clear that Travelers has an interest in the litigation that satisfies the second element. *National Union Fire Insurance Co. of Pittsburgh v. Continental Illinois Corporation*, 110 F.R.D. 608, 609 (N.D. Ill. 1986). As for the third element, any adverse decision in the litigation between Eljer and Liberty would not be binding on Travelers in that neither

party would be able to use collateral estoppel or *res judicata* against Travelers, though Travelers would likely be able to use it against them if the decision were favorable to Travelers. *See id.* at 610-11. Impairment of rights, however, can occur in that a decision adverse to the potential intervenor would have a *stare decisis* effect if appealed. *Meridian*, 683 F.2d at 204; *Atlantis Development Corp. v. United States*, 379 F.2d 818, 828-29 (5th Cir. 1967). Since the original parties are raising the same issues that Travelers is interested in, Travelers' interests could be impaired by an adverse decision.[6] The third element is satisfied.

The fourth element, however, is not satisfied. "Although the burden of proof on the party seeking to show lack of adequate representation is minimal, where it is established that the parties have the same ultimate objective in the underling action, the intervenors must demonstrate, as the very least, that some conflict exists." *Meridian*, 683 F.2d at 205. Travelers contended that its interests would not be adequately represented by Liberty or Highlands. Liberty and Highlands, like Travelers, have an interest in pushing the date of property damage to a later time so that they could possibly avoid having to cover the claim. While it is true that each party has its own particular period of time that it is interested in, this

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[6] In *National Union*, the original parties were contesting issues related to the potential intervenors' interests, but issues that would not themselves be involved in any dispute the potential intervenors might have had with the original parties. *See National Union*, 110 F.R.D. at 611. Thus, *National Union* is distinguishable on this issue.

does not necessarily result in adverse interests. Highlands would be interested in pushing all the property damage dates to a time after 1981, which would not be in Travelers' interest unless a greater amount of claims were also pushed beyond 1986. Liberty, however, has an interest in pushing the occurrence dates not only beyond 1986, but beyond 1988 as well. That Liberty may also have other interests peculiar to being the primary carrier does not change the fact that Liberty and Travelers have no conflict on the date of property damage issue. *Cf. Meridian,* 683 F.2d at 205 (that original party and potential intervenor had a conflict as to splitting profits between each other did not constitute a conflict preventing adequate representation where those parties had no conflict as to the legal issue in dispute with their common opponent). The lack of any conflict creating inadequate representation is also shown by the fact that Liberty and Travelers present essentially the same argument in support of their motions for summary judgment. Also, there does not appear to be any substantial conflict with Highlands, which did not even find it necessary to file any brief in addition to those of Liberty and Travelers.

Since Travelers does not satisfy the requirement for intervention as of right, it is unnecessary to determine if *Finley* changes the rule as to the necessity of an independent basis of jurisdiction. Even before *Finley,* such a requirement was applicable to permissive intervention. Travelers' motion to intervene was improvidently granted because it was only entitled to intervene permissively under Rule 24 (b). It should have been characterized as a defendant-intervenor opposing plaintiff Eljer, and there was no independent basis of jurisdiction for

such a claim in that Eljer (then incorporated as Household) and Travelers were both citizens of Illinois. Travelers' initial intervention complaint is dismissed for lack of subject matter jurisdiction.

The intervention question, however, does not end here. As of now, Eljer is not a citizen of Illinois. Therefore, there would be no jurisdictional problem with presently permitting Travelers to intervene as a defendant. Permissive intervention would be appropriate in that there is a common question of law. *See* October 27, 1988 Order. The only remaining issue would be one of timeliness. Given its prior involvement in this suit, no delay would occur as a result of presently permitting Travelers to intervene. Therefore, Travelers is dismissed from this case, curing any jurisdictional problem based on lack of complete diversity, and will be granted leave to permissibly intervene as a defendant on its filing of a proper motion so to do within five days of the date of this order. In the meantime, Travelers' brief will still be considered, as an *amicus curiae* brief since it is not a party. The Clerk of the Court will also be directed to correct the docket to list Highlands as a defendant-intervenor.

The parties agree that New York law governs as to the policies covering calendar years 1979 through 1982 and that Illinois law governs as to all subsequent policies. The parties also agree that there is no substantive difference between Illinois law and New York law so that Illinois law, the law of the state in which this court sits, can be applied to all the policies. *See Shore v. Dandurand*, 875 F.2d 656, 659 (7th Cir. 1989).

The parties agree that the focus of this case is the meaning of the contract language. *See Zurich Insurance Co. v. Raymark Industries, Inc.*, 118 Ill. 2d 23, 514 N.E.2d 150, 159 (1987); *American Home Products Corp. v. Liberty Mutual Insurance Co.*, 748 F.2d 760, 764 (2d Cir. 1984) (New York law); *Dow Chemical Co. v. Associated Indemnity Corp.*, 724 F. Supp. 474, 479-80 (E.D. Mich. 1989). Both forms expressly provide that property damage, not the occurrence, must occur within the policy period.[7] Both forms, however, contain one exception to this provision. " 'Property damage' that is loss of use of tangible property that is not physically injured shall be deemed to occur at the time of the 'occurrence' that caused it."[8] The claims against Eljer are of two general types: (1) those claims involving leaks and (2) those claims not involving leaks. The damages claimed in the first type of case can be divided into two categories: (a) damages caused to the structure or contents of the structure by the leaks and (b) the costs of replacing or repairing the system and any diminution in the value of the property distinct from the water damage caused by the leaks. In the second type of claim, that is the "non-leakers," only the second category of damages is claimed.

United States Fidelity & Guaranty Co. v. Wilkin Insulation Co., 193 Ill. App. 3d 1087, 550 N.E.2d 1032 (1st Dist.

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[7] This provision will be referred to as the "general rule," as distinguished from the "exception" set forth below.

[8] The earlier policies provide that property damage includes "loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period."

1989) ("*Wilkin I*"), *aff'd*, No. 70029, slip op. (Ill. May 20, 1991) ("*Wilkin II*"), is most instructive. While not addressing the timing and trigger issues involved in this case, *see Wilkin I*, 550 N.E.2d at 1038, the Illinois courts addressed the questions of what is meant by "property damage" and "occurrence" in insurance contracts containing the same language as involved in the present case. In *Wilkin I*, the court held that having asbestos-containing insulation in a building constituted property damage caused by an occurrence. *Id.* at 1038-39. The Appellate Court held that incorporation of asbestos in a property physically alters the structure itself and makes it harmful and therefore constitutes property damage under the policy. *Id.* at 1038. It was held that the physical alteration of adding a defective component to the building, not the resulting diminution in value, constitutes property damage. *See id.* at 1037-38. Alternatively, the Appellate Court held that, even absent physical injury, loss of use of the property constituted property damage under the second clause of the definition of property damage. *Id.* at 1038. Furthermore, the court held that, as long as the detrimental effects of asbestos were not foreseen, incorporating the asbestos into the building would constitute an occurrence in that it would be "an accident including continuous or repeated exposure to conditions which result in property damage or bodily injury, neither expected nor intended from the standpoint of the insured." *Id.* at 1038-39.

The Illinois Supreme Court affirmed the Appellate Court, but the Supreme Court's reasoning differed from that of the Appellate Court. The Illinois Supreme Court made clear that the property damage was the contamination of other portions of the structure by the toxic

asbestos fibers. *Wilkin II*, slip op. at 6. The Illinois Supreme Court also made clear that the release of asbestos fibers, not the installation of insulation, was the accident that constituted an occurrence. *Id.* at 7.

> In the instant action, the underlying complaints all allege that the asbestos-containing products continuously release toxic asbestos fibers into the air. This continuous release of asbestos fibers constitutes a harmful condition. By virtue of the "contiuous or repeated exposure to the condition" of asbestos fiber release, the buildings and their contents became contaminated. It is the continuous exposure of the buildings and their contents to released asbestos fibers which constitutes the "accident," as defined by the insurance policies. The "accident" results in "property damage." Therefore, the "property damage" alleged in the underlying complaints is caused by an "occurrence," as defined within the insurance policies.

Id.

Unlike the Appellate Court, the Illinois Supreme Court did not find that the installation itself was an occurrence. While it could be argued that the Illinois Supreme Court did not expressly decide that installation is not an occurrence, such a holding is implicit in *Wilkin II*. In holding that the continuous release of fibers was an accident constituting an occurrence, the Illinois Supreme Court distinguished the intentional act of installing the asbestos-containing insulation from the unintended result of fibers being released. *See id.* at 7. The court further states: "Plaintiffs misread the definition of 'occurrence' contained in the policies. Under this definition, it is the

'property damage' which must be 'neither expected nor intended from the standpoint of the insured.' Therefore, it is the contamination of the buildings and their contents that must be neither expected nor intended by Wilkin. We have reviewed the underlying complaints and are unable to find any allegations that Wilkin 'expected or intended' to contaminate the buildings and the contents therein with toxic asbestos fibers." *Id.* at 8.

Wilkin II's discussion of the exclusionary clauses of the policies involved in that case is also instructive. The policies contained a "sistership" exclusion excluding from coverage "[d]amages claimed for the withdrawal, inspection, repair, replacement or loss of use of the named insured's products or work completed by or for the named insured or of any property of which such products or work form a part, if such products, work or property are withdrawn from the market or from use because of any known or suspected defect or deficiency therein."[9] *See id.* at 10. That exclusion did not prevent coverage because, in *Wilken II*:

> the underlying complaints allege that the asbestos-containing product has already failed while in use, resulting in damage to the property of the building owners. The underlying complaints seek damages for the inspection of the buildings and the removal and replacement of this product, not as the cost of a preventative action withdrawing sister products from the market, but as a measure of the property damage which has already been incurred by reason

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[9] In the present case, Exclusion (p) of the older policies is identical. Exclusion (n) of the newer policies is similar.

> of this product. Therefore, we hold that the policies' "sistership" exclusions are inapplicable. . . .

Id. at 10-11.

The policies also excluded "property damage to the insured's products arising out of such products or any part of such products" and "property damage to work performed by or on behalf of the insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith."[10] *See id.* at 11.

> Plaintiffs argue that these exclusions apply in the instant action, pointing to the fact that the underlying complaints seek recovery for the costs of the removal, repair and/or replacement of the asbestos-containing product. However, plaintiffs fail to recognize that the underlying complaints seek these damages as a result of the contamination visited upon the buildings and the contents therein by the product that Wilkin installed. As such, the underlying complaints seek recovery for damage to property other than the product installed by Wilkin or Wilkin's workmanship. Therefore, these exclusionary clauses are inapplicable to the case at bar.

Id.

Wilkin I indicates that incorporation of a defective product into a structure is itself property damage and

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[10] Exclusions (n) and (o) of the older policies are essentially identical. Exclusions (k) and (l) of the newer policies are similar.

thus would support Eljer's contention that property damage occurred at the time Qest Systems were installed.[11] That aspect of the Appellate Court's decision, however, cannot be considered good law in light of the reasoning set forth in *Wilkin II* for affirming the Appellate Court's decision. *Wilkin II* makes clear that property damage under the type of insurance contracts involved in the present case is the damage to other parts of the structure or the contents of the structure. Even the costs of repairing or replacing an insured's products that have been incorporated in the structure are only measures of monetary compensation; "property damage" as used in the policies is the asbestos contamination or, in the present case, the occurrence of water damage. Following *Wilkin II*, the repair and replacement costs related to the defective Qest Systems would be measures of compensation for the water damage, which is the actual property damages as that term is used in the insurance policies. Since, in *Wilkin II*, the repair and replacement costs could be associated with asbestos-contamination, it was unnecessary to determine if repair and replacement costs could be measures of other types of property damage as well.

Having identified water damage as an event that constitutes property damage under the insurance policies, the trigger for insurance coverage can more readily be identified. Under the general rule, it is the occurrence

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[11] Even accepting this theory, though, the water damage, in contrast with the repair costs, replacement costs and diminution in value, would probably still not be considered to have occurred until there was actual water damage. *Cf. Greenlee v. Sherman*, 142 A.D.2d 472, 536 N.Y.S.2d 877, 880-81 (3d Dept. 1989).

of property damage that must fall within the policy period. Water damage does not occur until pipes leak. Therefore, in the "leaker" cases, the applicable policy is the one in effect at the time the water leaks and causes damage to the structure or contents of the structure. As indicated by *Wilkin II*, related repair or replacement costs, and presumably diminution in value expenses as well, are measures of the amount of compensatory damages, but the water damage to the property is the actual property damage. Even if repairs were not done until a later period of time or the diminution in value was not recognized until later, the covered damages represented by those costs are considered to have occurred at the time of the actual leaks. Such a holding is consistent with the plain language of the policy which covers "physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof *at any time* resulting therefrom."

This holding is consistent with New York law. *Greenlee v. Sherman*, 142 A.D.2d 472, 536 N.Y.S.2d 877, 880-81 (3d Dept. 1989), for example, makes clear that fire damage to a structure is distinct from damage to the defective product that caused the fire and that the fire damage occurs at the time the other property is physically injured by the fire, not when the defective product is physically injured. Water damage to a homeowner's walls, mattress, or other property is clearly physical injury to tangible property and thus clearly is property damage. Similar to fire damage to a structure or its contents occurring at the time the property burns, water damage to a structure or its contents occurs when the property becomes wet; it does not occur when the Qest System is first installed. As

was pointed out in *Greenlee*, 536 N.Y.S.2d at 881, with regard to the defective furnace involved in that case and the ability to prevent a fire, if the defective plumbing system had been repaired before leaks occurred, no water damage would have ever occurred. Therefore, the water damage was not inevitable and, even if progressive deterioration occurred within the policy period, water damage could still have been prevented. Water damage cannot be considered to have occurred until property gets wet.

Eljer argues that property damage occurs from the moment the Qest System is installed because deterioration of the system begins the moment the system is installed and this constitutes physical injury to tangible property.[12] The problem with this argument is that the deterioration of the pipe is not itself covered property damage. While deterioration of the Qest System itself may very well constitute physical injury to tangible property that occurs within a policy period, such property damage is excluded from coverage under various exclusions contained in the policies. Coverable property damage does not occur until the system deteriorates to the point that it causes damage to other parts of the structure or contents of the structure as is indicated by the discussion of exclusions contained in *Wilken II*, slip op. at 10-11.[13]

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[12] On the record before the court, it cannot be determined what the actual cause of the Qest System failures were. For purposes of deciding the pending motions and issuing a declaratory judgment, however, it can be assumed that at least some of the claims for which Eljer seeks coverage involved progressive deterioration of the pipe that began the moment of installation.

[13] Construction of the exclusions is not an issue directly presented to this court. The discussion of the exclusions in this

Eljer relies on cases that it contends hold to the contrary. In *Ohio Casualty Insurance Co. v. Bazzi Construction Co.*, 815 F.2d 1146 (7th Cir. 1987) (Illinois law), it was held that defective design or improper pouring of concrete for the second floor of a parking garage constituted property damage under a comprehensive general liability policy like that involved in the present case. In *Bazzi*, there was not merely damage to and defects in the insured's own work, but also damage to the structural integrity of the entire building. *See id.* at 1147-48. *Bazzi* was expressly distinguished from other cases that involved damage solely to the product or work of the insured. *See id.* at 1148. The present situation is distinguishable because, prior to any leaks, there is no damage to other parts of the structure and the structural integrity of the building is still sound. Once leaks occur, however, the structural integrity of the residential unit may very well be threatened or the building may be essentially uninhabitable because the water system cannot be used without causing further damage.

Eljer also relies on *W.E. O'Neil Construction Co. v. National Union Fire Insurance Co. of Pittsburgh*, 721 F. Supp. 984 (N.D. Ill. 1989). That case involved defective steel mesh inside the concrete of a four-level parking garage that caused cracks in the floors and walls throughout the garage. It was held that the damage to the structure, but not the defective mesh, was property damage under an

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case should not be considered a full delineation of which portions of repair and replacement costs are covered by the policies. A declaration as to the precise meaning of the exclusions is not requested and will not be provided.

insurance policy containing the same language as is involved in the present case. Contrary to Eljer's reliance on *O'Neil*, this case does not support Eljer's position since it holds that defects in the insured's product do not constitute property damage. *O'Neil* states the general rule that "Where a defective product manufactured or installed by the insured has been integrated with someone else's property, it is clear that damage to that property as a whole, *excluding the cost of repairing or replacing the defective part*, constitutes property damage." *Id.* at 991 (emphasis added). *O'Neil* makes clear that the defect in the product itself is not property damage. *Id.* at 992 (quoting *Hamilton Die Cast, Inc. v. United States Fidelity & Guaranty Co.*, 508 F.2d 417, 419-20 (7th Cir. 1975) (applying Ohio law, but assuming Ohio law is consistent with Illinois law)).[14] Just as there were cracks in the parking garage in *O'Neil*, leaks in and water damage from a residential unit's Qest System would constitute damage to the overall structure.

Two Illinois Appellate Court cases pre-dating the form contract language involved in the present case involved incorporation of defective parts in a larger product. *See Pittway Corp. v. American Motorists Insurance Co.*, 56 Ill. App. 3d 338, 370 N.E.2d 1271, 1275 (2d Dist. 1977); *Elco Industries, Inc. v. Liberty Mutual Insurance Co.*, 46 Ill. App. 3d 936, 361 N.E.2d 589 (1st Dist. 1977). As was

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[14] It is noted that two Illinois Appellate Court cases have rejected the holding in *Hamilton Die*. *See Wilkin I*, 550 N.E.2d at 1037-38; *Pittway Corp. v. American Motorists Insurance Co.*, 56 Ill. App. 3d 338, 370 N.E.2d 1271, 1275 (2d Dist. 1977). *See also McDowell-Wellman Engineering Co. v. Hartford Accident & Indemnity Co.*, 711 F.2d 521, 525 n.5 (3d Cir. 1983).

stated in *Pittway*, 370 N.E.2d at 1274, "we have found what we conclude to be a majority position which holds the term 'property damage' includes tangible property which has been diminished in value or made useless irrespective of any actual physical injury to the tangible property." Both cases, however, involved a definition of property damage as being "injury to or destruction of tangible property." Thus, in those cases, "injury to . . . tangible property" could constitute property damage, whereas the present case requires, under the general rule, "*physical* injury to . . . tangible property." Nevertheless, a more recent Illinois case involving the same contract language as in the present case holds that *Elco* and *Pittway* are still controlling law. *See Marathon Plastics, Inc. v. International Insurance Co.*, 161 Ill. App. 3d 452, 514 N.E.2d 479, 484-86 (4th Dist. 1987), *leave to appeal denied*, 119 Ill. 2d 559, 522 N.E.2d 1246 (1988). This court must defer to the Illinois Appellate Court on issues of Illinois law unless there is good reason to believe and persuasive data that the Illinois Supreme Court would reject the holdings of the appellate courts. *See First Comics, Inc. v. World Color Press, Inc.*, 884 F.2d 1033, 1038 (7th Cir. 1989), *cert. denied*, 110 S. Ct. 1123 (1990); *Peeler v. Village of Kingston Mines*, 862 F.2d 135, 137 (7th Cir. 1988); *Sommers v. 13300 Brandon Corp.*, 712 F. Supp. 702, 704 (N.D. Ill. 1989).

To the extent *Elco* and *Pittway* hold that *physical* injury to be tangible property is not necessary for there to be property damage, those two cases are distinguishable because they involve different contract language. This holding of these two cases, however, has been largely incorporated into the language of the policies involved in this case. The exception incorporates this holding, though

it only covers loss of use without physical injury, not mere diminution in value can itself be property damage and apparently relies on the general rule of the policies, not the exception.[15] 514 N.E.2d at 485. Given the plain language of the policy that physical injury is required[16] and in light of *Wilkin II*'s discussion of the exclusions, there is persuasive evidence that repair costs, replacement costs, and diminution of value are not property damage under the general rule, nor even measures of property damage, absent *physical* injury to tangible property.

There is, however, another aspect of property damage that involves physical injury to tangible property and which is not inconsistent with the holding in *Wilkin II*. Liberty concedes that where repair or replacement of the insured's product requires damaging other parts of the structure in order to perform the replacement or repair, this damage to other parts of the structure constitutes property damage. *See Elco*, 361 N.E.2d at 591-92. In the present case, the breaking of walls, floors, and ceilings

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[15] Although *Marathon* states that there is property damage without physical injury based on diminution in value, the basis for there being diminution in value is that the insured's gaskets were leaking and therefore the water system which the gaskets were part of became useless. *See id.*, 514 N.E.2d at 485. It is also noted that *Wilkin I*, 550 N.E.2d at 1037-38, holds that diminution in value is not itself property damage.

[16] *Marathon* referred to the contract language involved in *Pittway* as being "virtually identical" to the language involved in *Marathon* and the present case. *Marathon*, 514 N.E.2d at 484. *Marathon* does not expressly address why the addition of the word "physical" has no effect on the holdings of *Pittway and Elco*.

that must be done in order to have access to repairing or replacing the Qest System constitutes property damage. As regards the leaker cases, this type of property damage does not occur until after the leaks have occurred. Thus, the date of coverage for the damage would not be any earlier than it is when measuring it by the date of leaks. In any event, under the policies, covered damages for the leaker cases is covered by the policy in effect at the time leaks or water damage occurred and also by the policy in effect at the time repair or replacement work was performed.

The question still remains as to what policy covers damages in the non-leaker cases. In the cases where repairs or replacement work was performed, the policies in effect at the time that work was performed would provide coverage just as in the non-leaker cases. The non-leaker cases, however, can also fall under the exception. If, prior to leaks occurring, a residential unit's plumbing system could not be used out of fear that it would begin to leak and cause further damage, there would be loss of use without physical injury to tangible property. Under the exception, coverage would be in effect at the time of the occurrence, not the time of any physical injury. The policies define occurrence as "an accident including continuous or repeated exposure to conditions."[17] The continuous exposure to the defective plumbing system is the occurrence. *See Wilken II*, slip op. at 7. Since exposure occurs from the time the Qest System is first installed in

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[17] The newer policies refer to "an accident, including continuous or repeated exposure to substantially the same general harmful conditions."

the residential unit, that is when the occurrence begins. Although property damage in the form of loss of use does not happen until later, the terms of the policy expressly provide that such property damage will be deemed to have occurred at the time of the occurrence. Any non-leaker claims for loss of use without physical injury are covered by the policy in effect at the time of installation and any subsequent policies in effect while the exposure continues.[18] *See Raymark*, 514 N.E.2d at 165.

Liberty argues that the non-leaker cases should be considered to occur at the time the owner becomes aware the Qest System is defective. Liberty relies on *Bob Evans Farms, Inc. v. Excellent Builders, Inc.*, No. 84 C 506 (N.D. Ill. July 27, 1986). Using awareness or discovery as the measuring point, however, is not appropriate. First, the language of the insurance policy does not include any direct incorporation of a discovery rule. *See American Home Products Corp. v. Liberty Mutual Insurance Co.*, 748 F.2d 760, 764 (2d Cir. 1984) (New York law); *Dow Chemical*, 724 F. Supp. at 481. Second, the rationale for using such a measure is inapplicable or inconsistent with Illinois law. *Bob Evans* does not expressly set forth the rationale for its

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[18] *Young v. Insurance Co. of North America*, 870 F.2d 610, 611 (11th Cir. 1989) (per curiam) (New York law), indicates that New York law does not recognize exposure to a potential hazard as a trigger for coverage. *Young*, however, involved a negligently installed gas grill that caused $350,000 of fire damage to the house where it was located. Coverage for the fire damage was triggered by the actual occurrence of a fire just as coverage for water damage in the present case is triggered by the occurrence of leaks. *Young*, therefore, involved the general rule, not the exception that is presently held to be triggered by exposure.

ruling, but relies on two cases. *See Mraz v. Canadian Universal Insurance Co.*, 804 F.2d 1325, 1328 (4th Cir. 1986); *American Home Assurance Co. v. Libbey-Owens-Ford Co.*, 786 F.2d 22, 29-30 (1st Cir. 1986). *Mraz* involved leakage of hazardous waste. The court chose the date of discovery because determining the date of first leakage was difficult, if not impossible. Such a rationale is inapplicable to the non-leaker cases because here the date of installation or repair is a better documented and more readily determinable date than the date the owner discovered or should have discovered the Qest System was defective.

American Home does not expressly set forth a rationale, but it cites two cases. One of the cases does not set forth a rationale. *See Bartholomew v. Insurance Co. of North American*, 502 F. Supp. 246 (D.R.I. 1980), *aff'd sub nom., Bartholomew v. Appalachian Insurance Co.*, 655 F.2d 27 (1st Cir. 1981). Also, *Bartholomew* involved the reverse situation where the insured wanted the occurrence to be later so that he could make a claim under new coverage. The other case relied on by *American Home* sets forth a rationale. *United States Fidelity & Guaranty Co. v. American Insurance Co.*, 345 N.E.2d 267, 271 (Ind. Ct. App. 1976), involved damage to a structure from spalling bricks. The court held that the covered property damage was damage to the structure, not damage to the bricks themselves. Thus, replacement of the bricks was not covered, but the diminished value of the building caused by the fading brick was covered. The court reasoned, therefore, that the time at which the fading became noticeable measured whether the property damage fell within the coverage period. Such reasoning implicitly relies on diminution in value as being the property damage. This court has held,

however, that diminution in value is not itself property damage; it is only a possible measure of compensation for property damage. While it is perfectly reasonable to presume that property values drop at the same time the defective nature of the product is discovered, such a rationale is not appropriately applied in this case because the drop in value of the structure is not itself property damage or an occurrence and, under the insurance policies, it is property damage that must fall within the policy period under the general rule or an occurrence that must fall within the policy period under the exception. For the foregoing reasons, *Bob Evans*'s discovery rule will not be followed.

IT IS THEREFORE ORDERED that:

(1) The intervening complaint of "plaintiff-intervenor" Travelers Indemnity Company of Illinois ("Travelers") is dismissed for lack of subject matter jurisdiction.

(2) Travelers is granted leave to intervene as a defendant-intervenor if a motion so to do is filed within five days of the date of this order. The Clerk of the Court is directed to amend the docket to redesignate Highlands as a defendant-intervenor.

(3) Travelers' motion to supplement the record is denied.

(4) Each party's motion for summary judgment is granted in part and denied in part.

(5) The Clerk of the Court is directed to enter a final declaratory judgment on all pending claims as follows: "Whereas Household Manufacturing, Inc. n/k/a Eljer Manufacturing, Inc. ("Eljer"), Liberty Mutual Insurance

Company, and Highlands Insurance Company, and Highlands Insurance Company have requested a declaration as to the policy period within which certain claims related to the Qest Qick/Sert II residential polybutylene system ("Qest System") fall under the various policies of insurance issued by the other parties to Eljer and its predecessor corporations, it is hereby declared that: (1) all covered claims for water damage are covered by the policy or policies in effect at the time the water damage occurred; (2) all covered claims for loss of use of structure as a result of leaks in the Qest system is [sic] covered by the policy in effect at the time the leak occurred; (3) all covered claims for repairing or replacing the Qest System are covered by the policy or policies in effect at the time the repair or replacement work is performed; (4) all covered claims where no leaks have occurred at the residential unit but where there has been a loss of use of property are covered by the policy or policies in effect from the time the Qest System was first installed until the unit's plumbing system was repaired or replaced."

ENTER:

/s/ William T. Hart
UNITED STATES DISTRICT JUDGE

Dated: JUNE 14, 1991

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

ELJER MANUFACTURING, INC., a Delaware corporation, and Successor in Interest to HOUSEHOLD MANUFACTURING, INC.,	)	No. 88 C 3143
Plaintiff,	)	
v.	)	
LIBERTY MUTUAL INSURANCE COMPANY, a Massachusetts corporation,	)	
Defendant,	)	
THE TRAVELERS INDEMNITY COMPANY OF ILLINOIS, and HIGHLANDS INSURANCE COMPANY,	)	
Intervening Defendants.	)	

MEMORANDUM OPINION AND ORDER ON RECONSIDERATION

On June 14, 1991, this court ruled on the pending cross motions for summary judgment and directed the Clerk of the Court to enter judgment. A judgment was entered on June 18. On June 24, Eljer filed a notice of appeal. On June 28, Travelers filed a timely Rule 59(e) motion and on July 2 Eljer filed a timely Rule 59(e)

motion.[1] *See* Fed. R. Civ. P. 59(e). The timely filing of the Rule 59(e) motions result in the notice of appeal having no effect[2] and this court has jurisdiction to consider the pending motions for reconsideration.[3] *Turner v. Chicago Housing Authority*, ___ F. Supp. ___, ___ & n.1 (N.D. Ill. July 26, 1991).

Travelers contends, and Liberty agrees, that Travelers' intervention as a plaintiff was proper and that Travelers was entitled to intervene as of right pursuant to Fed. R. Civ. P. 24(a). Travelers contends that it was adverse to Liberty on the noncumulation issue involved in Count I and that, even though adverse to Eljer on Count II, Liberty could not adequately represent Travelers' interests as to that issue. Count I was settled and Travelers does not dispute that presently it should be aligned as a defendant adverse to Eljer. Eljer expresses the view that the June 14 ruling as to intervention was correct.

There is no need to reconsider the issue of intervention. The better course is to realign Travelers and grant

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[1] Although presented on July 5, the motions were filed on the dates indicated in the text. *See* N.D. Ill. Local Rule 12(d).

[2] The Seventh Circuit subsequently granted a motion to voluntarily dismiss the appeal.

[3] On July 5, a motion to amend to indicate that Count I was settled was granted and, since Highlands disclaimed any interest in Count II, Highlands' intervention complaint was dismissed as moot. It is also noted that Liberty did not move for reconsideration, but was permitted to respond to the motions of Eljer and Travelers. Liberty expresses the view that the rulings on the merits of the insurance issues should not be disturbed except for one point on which it agrees with Travelers.

the pending motion to intervene as a defendant so as to cure any possible jurisdictional defects.

All three parties agree that the only issue they considered to be before the court was interpretation of the primary policies issued by Liberty. Although the umbrella policies "follow in form" and therefore any ruling would appear to apply equally to the umbrella policies, the parties are the masters of their lawsuit. The declaratory judgment will be amended to indicate that only the primary policies are at issue. Travelers and Liberty also contend that the issue of loss of use without physical injury to property was not before the court. That issue, however, was referred to in the briefs and the court agrees with Eljer that there is a sufficient factual foundation to bring that issue before the court.

Eljer argues that the holding of *Wilkin I*, that incorporation of a defective product into a building constitutes property damage, must be deferred to as a statement of Illinois law. *See United States Fidelity & Guaranty Co. v. Wilkin Insulation Co.*, 193 Ill. App. 3d 1087, 550 N.E.2d 1032 (1st Dist. 1989) (*"Wilkin I"*), *aff'd*, No. 70029, slip op. (Ill. May 20, 1991) (*"Wilkin II"*). The holdings of *Wilkin I* and earlier Illinois Appellate Court cases that Eljer relies on were fully discussed in the June 14 order and it was explained why that holding of *Wilkin I* could not be

followed in light of *Wilkin II*.[4] Eljer does not raise any issues that require further discussion.

Eljer and Liberty are correct in pointing out that the ruling as to loss of use without physical injury is superficially inconsistent with the ruling in the earlier suit between Eljer and Liberty. *See Household Manufacturing, Inc. v. Liberty Mutual Insurance Co.*, No. 85 C 8519 (N.D. Ill. Feb. 10, 1987), *reconsideration granted*, (Nov. 16, 1987). In that case, it was held that all claims based on Qest System failures resulted from a single occurrence. Since loss of use without physical injury claims are based on the time of the occurrence that caused the loss of injury, it can be argued that the occurrence that caused the loss of use is the one continuous occurrence underlying this entire litigation.[5] The clause at issue provides: "'property damage' means . . . loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period."[6] Loss of use is only *caused* during the time that the Qest System is in the residential unit and

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[4] Travelers and Liberty also point to a recent decision of the First District Illinois Appellate Court that is consistent with the June 14 interpretation of *Wilkin I and Wilkin II*. *See Bituminous Casualty Corp. v. Gust K. Newberg Construction Co.*, No. 1-90-2292, slip. op. (1st Dist. Ill. App. July 19, 1991).

[5] Eljer, the insured, makes no such argument; only the insurers make such an argument. Since Eljer does not pursue such a line of argument, to the extent the policy is ambiguous, it need not be construed against the insurers.

[6] Policies in the later years provide: " 'Property damage' that is loss of use of tangible property that is not physically injured shall be deemed to occur at the time of the 'occurrence' that caused it."

not yet repaired. Therefore, the June 14 ruling and declaratory judgment is consistent with the 1987 ruling that there is only one occurrence.

IT IS THEREFORE ORDERED that:

(1) Travelers' motion to intervene as a party defendant is granted.

(2) Travelers' motion to amend this court's memorandum opinion and order and judgment and Eljer's motion to alter or amend the judgment are granted in part and denied in part.

(3) The judgment dated June 14, 1991 and entered on the docket June 18, 1991 is vacated.

(4) The Clerk of the Court is directed to enter a final judgment dismissing Count I of Eljer's complaint as settled and Highland's complaint in intervention as settled and as to all other pending matters issue a final declaratory judgment as follows: "Household Manufacturing, Inc. n/k/a Eljer Manufacturing, Inc. ("Eljer"), Liberty Mutual Insurance Company ("Liberty"), and The Travelers Indemnity Company of Illinois have requested a declaration as to the policy period within which certain claims related to the Qest Qick/Sert II residential polybutylene system ("Qest System") fall under the various policies of primary insurance issued by Liberty to Eljer and its predecessor corporations. It is hereby declared that: (1) all covered claims for water damage are covered by the policy or policies in effect at the time the water damage occurred; (2) all covered claims for loss of use of structure as a result of a leak or leaks in the Qest System are covered by the policy or policies in effect at the time

or times the leak or leaks occurred; (3) all covered claims for repairing or replacing the Qest System are covered by the policy or policies in effect at the time the repair or replacement work is performed irrespective of whether or not a leak occurred; and (4) all covered claims where water damage has not occurred at the residential unit but where there has been a loss of use of property are covered by the policy or policies in effect from the time the Qest System was first installed until the unit's plumbing system was repaired or replaced."

ENTER:

/s/ William T. Hart
UNITED STATES
DISTRICT JUDGE

Dated: AUGUST 23 1991

APPENDIX D

UNITED STATES COURT OF APPEALS

For the Seventh Circuit

Chicago, Illinois 60604

November 5, 1992

Before

Hon. Richard D. Cudahy, Circuit Judge

Hon. Richard A. Posner, Circuit Judge

Hon. Michael S. Kanne, Circuit Judge

ELJER MANUFACTURING, INCORPORATED, *Plaintiff-Appellant,* Nos. 91-3203, 91-3251, 91-3298 v. LIBERTY MUTUAL INSURANCE COMPANY, *Defendant-Appellee,* and TRAVELERS INDEMNITY COMPANY OF ILLINOIS, *Intervening-Defendant-Appellee.*	Appeals from the United States District Court for the Northern District of Illinois, Eastern Division. No. 88 C 3143 William T. Hart, *Judge.*

ORDER

On August 28, 1992, defendant-appellee and intervening-defendant-appellee filed petitions for rehearing with suggestions for rehearing en banc. A majority of the

judges on the original panel has voted to deny the petitions, and none of the active judges* has requested a vote on the suggestions for rehearing en banc. The petitions are therefore DENIED.

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* Hon. Walter J. Cummings took no part in the consideration of the suggestions for rehearing en banc.